June 2008
IMF Country Report No. 08/171

Kingdom of the Netherlands—Netherlands: 2008 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Kingdom of the Netherlands—Netherlands

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2008 Article IV consultation with the Kingdom of the Netherlands—Netherlands, the following documents have been released and are included in this package:

- The staff report for the 2008 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 17, 2008, with the officials of the Kingdom of the Netherlands—Netherlands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 25, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of May 21, 2008 updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 21, 2008 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for the Kingdom of the Netherlands—Netherlands.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—THE NETHERLANDS

Staff Report for the 2008 Article IV Consultation

Prepared by Staff Representatives for the 2008 Consultation with the Netherlands

Approved by Juha Kähkönen and Michael T. Hadjimichael

April 25, 2008

EXECUTIVE SUMMARY

Strong macroeconomic foundations have so far largely shielded the Netherlands from financial turbulence. In recent years, growth has been above and inflation below euro area averages. Staff expects growth to slow to about 2 percent in 2008, which, in light of a large carryover from 2007, reflects a rapid deceleration owing to the global turmoil and the spillover from the U.S. downturn. The authorities' growth projections are more sanguine. Inflation should stay subdued, slightly above 2 percent. However, with a tightening labor market, wages are anticipated to accelerate. Uncertainties regarding the outlook are high, but risks broadly balanced. Officials concurred that external competitiveness is broadly adequate.

Staff saw merit in a somewhat tighter fiscal stance from both cyclical and long-term sustainability perspectives. The structural balance slipped by about ½ percent of GDP in 2007 and would again weaken in 2008-09, net of gas receipts and interest payments. With output above potential and mounting labor market pressures, some withdrawal of fiscal impulse would instead be appropriate. The authorities expressed conditional support for saving potential margins under the expenditure ceilings, as spending pressures may prevent them from doing so. For 2011, staff broadly endorses the government target of 1 percent of GDP structural surplus. However, owing to population aging, sustainability requires further correction (2¼ percent of GDP). Front-loading it would benefit intergenerational equity. There was agreement that adjustment should focus on expenditure retrenchment or tax base broadening.

The authorities concurred that structural reforms are essential to raise long-term growth and help secure fiscal sustainability. Reforms of the tax system, social entitlements, and employment protection, would alleviate the effects of population aging on employment, but needed consensus among social partners will take time. Recent actions to boost competition and innovation are welcome, although officials approach cautiously further liberalization required to stimulate productivity, which has been lagging.

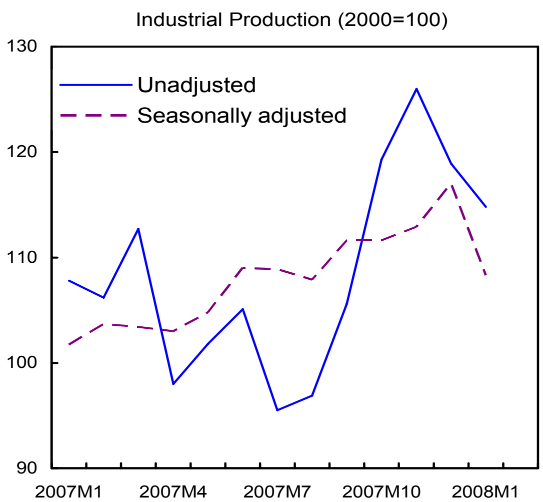
The Dutch financial system appears robust, albeit the authorities recognize some concerns. Risk-weighted capital ratios of banks are comfortable, though return on assets remains low. Stress tests suggest that banks can withstand the current global turmoil. The mortgage market carries low risks, but house prices, high mortgage debt, risk concentration, and growing securitization require careful watch. Takeover of a large Dutch bank by an international consortium typifies rising challenges for cross-country supervision.

Contents Page

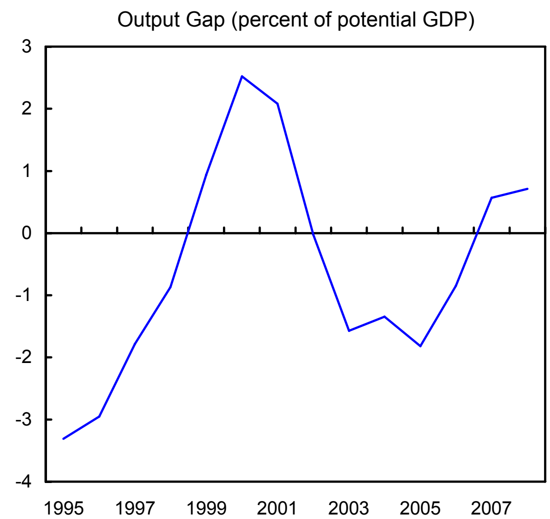
I. Macroeconomic Situation

1. **The Dutch economy is doing well, but important challenges lie ahead.** Following the prolonged stagnation early in the decade, a solid recovery has taken root, with growth above and inflation below euro area averages, unemployment decreasing, and the fiscal position strong (Figures 1-2). The expansion is set to continue, but uncertainties associated with the recent financial market turbulence are high. Looking forward, moreover, rapid aging and sluggish productivity are twin threats to longer-term growth, competitiveness, and fiscal sustainability. And comparatively weak bank profitability, complex products, and growing financial integration create new risks and supervisory challenges.

2. **Strong macroeconomic foundations have so far largely shielded the Netherlands from recent financial turbulence.** With growth of 3½ percent in 2007, output is estimated to have topped potential (Table 1). Growth surged to 4.1 percent (y-o-y) in the second half of 2007—the highest rate in more than seven years. The expansion has been broad based, with a rebound in consumption, strong investment, and a positive external contribution.

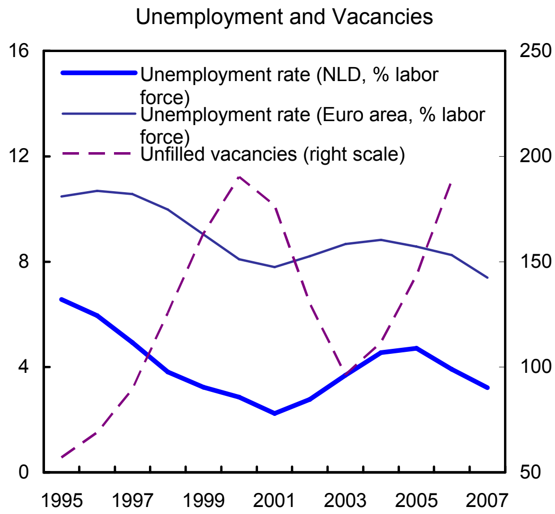


Source: Netherlands authorities.

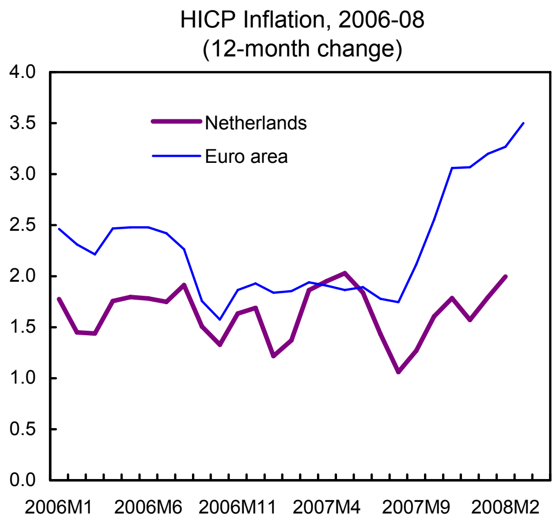


Sources: Netherlands authorities and staff estimates.

3. **Despite a tightening labor market, inflation remains subdued.** Employment grew 1¼–1½ percent in 2007, on par with the rest of the euro area. However, about half of the new jobs are through temporary agencies, given strict employment protection legislation (EPL) for permanent workers. The unemployment rate fell to 3.4 percent, less than half the euro area average, while registered vacancies have rebounded sharply. These growing labor market tensions notwithstanding, inflation has been restrained, reaching 2 percent only this February.

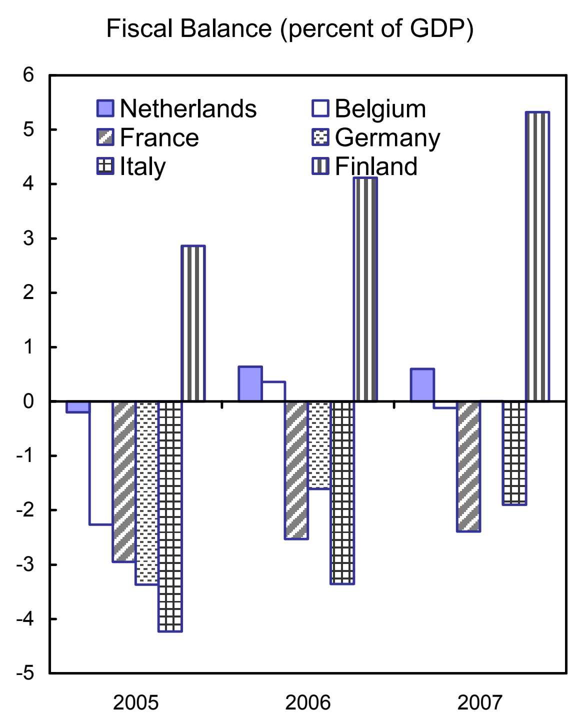


Sources: Global Insight; and IMF, WEO.



4. **The external current account surplus remains large, and various approaches suggest that Dutch competitiveness is satisfactory.** Although mild weather dampened gas exports in the winter of 2006-07, the underlying export performance continued to be robust. The current account surplus reached 6¾ percent of GDP in 2007, about 1½ percentage points off the 2006 total. These developments, as well as various measures of the real effective exchange rate, together with application of the CGER methodology and other econometric tests to the Netherlands, point to adequate external competitiveness (Box 1 and Figure 4).

5. **Fiscal performance, while staying strong, was mildly pro-cyclical in 2007.** The general government balance improved by a cumulative 3¾ percent of GDP over 2004-06, mostly owing to buoyant revenues. In 2007, it was broadly unchanged, posting a modest surplus. But in cyclically-adjusted terms it slipped about ½ percent of GDP, in light of the vanishing output gap (Table 2). This reflected the absence of an expenditure ceiling during the government interregnum as well as discretionary decisions. Nevertheless, the general government debt ratio, now about 46 percent of GDP, continued on its declining path, comfortably below the Maastricht limit.

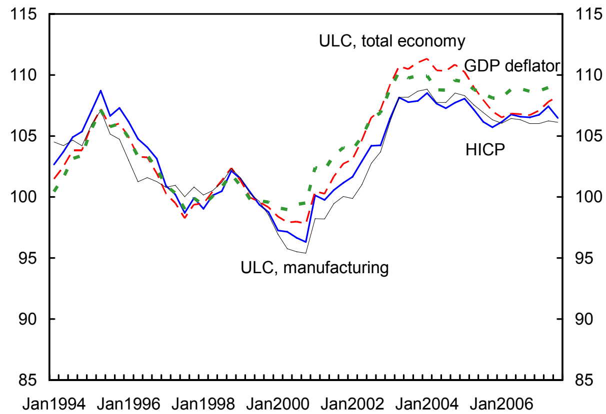


Box 1. Netherlands' External Competitiveness

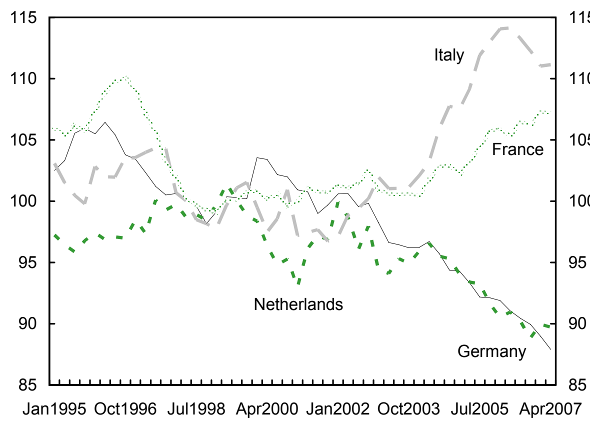
Various standard real effective exchange rate (REER) measures have been relatively stable in recent years. Following a sizable real appreciation in 2001-03, REER gauges based on different price or cost indices have moved little (top panel and Figure 3). Manufacturing unit labor costs (ULCM) have fallen for the last four years at a pace largely on par with trading partners, and low inflation has limited the increase in the CPI-based REER.

However, a measure of exporter profitability displays a marked improvement. Proxying profitability of the tradables sector by the ratio of the ULCM-based REER to the REER using industry deflators suggests a persistent amelioration since 2002, similar in magnitude to Germany (and unlike the worsening trend for Italy and France). This is because, although the ULCM-REER has risen, the industrial-output-deflator-REER improved even more over the same period.

REER measures have been broadly stable...



...while labor's income share in manufacturing has fallen. 1/



Source: European Commission; and staff calculations.
1/ Proxied by the ratio of industry price deflator-based REERs to ULMC-based REERs.

Applying the multilaterally-consistent CGER methodology to the Netherlands indicates that the real exchange rate is broadly in equilibrium. In particular, in the macroeconomic balance approach, the current account (CA) norm of 5.8 percent of GDP tracks closely the underlying medium-term CA surplus. The CA norm reflects largely the importance of the financial sector as well as of old-age pre-funding for the Dutch overall savings rate.

Equilibrium Real Exchange Rate Estimates Using the CGER Methodology
(Level relative to equilibrium in percent; minus indicates undervaluation)

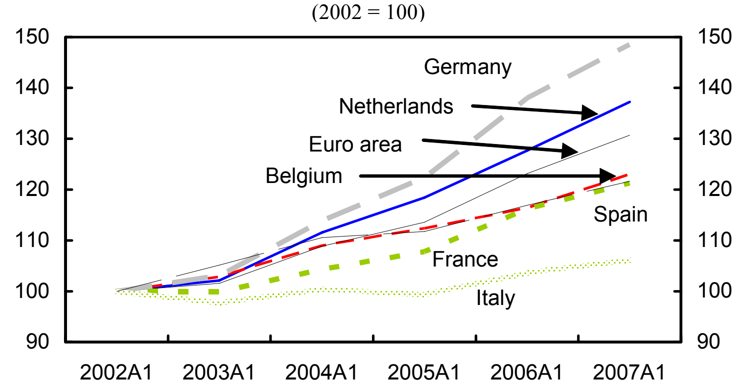
	CGER Methodology			CA/GDP			CA Norm Contributions						
	MB 2/	ERER 3/	ES 4/	2007	2012 WEO	CA/GDP Norm 2/	CA lag	Dependency ratio	Population growth	Per capita growth	Relative income	Financial center	Other 5/
Netherlands	**1.0**	**4.0**	**-9.0**	6.8	5.2	5.8	2.4	0.3	0.1	0.0	-0.3	3.1	0.5
Germany	-2.0	3.0	-10.0	5.6	3.8	3.3	1.3	0.8	0.5	0.0	-0.5	n.a.	1.2

1/ CGER (Consultative Group on Exchange Rate Issues). Values between -10 and +10 mean the real exchange rate (RER) is close to balance. International Monetary Fund, 2006, Methodology for CGER Exchange Rate Assessments (available at www.imf.org).
2/ Macroeconomic balance approach.
3/ Equilibrium real exchange rate approach.
4/ External sustainability approach.
5/ Oil balance to GDP, and dummies for the EMU creation.

Box 1. Netherlands' External Competitiveness (concluded)

Rapid export growth also suggests that external competitiveness is not at stake. With cumulative real growth of almost 40 percent since 2002, Dutch export growth exceeds the Euro area average, and lags only that in Germany among major euro area economies. Also, the growth of reexports—which represent about half of Dutch exports in value—has been very strong.

Real Export Growth
(2002 = 100)

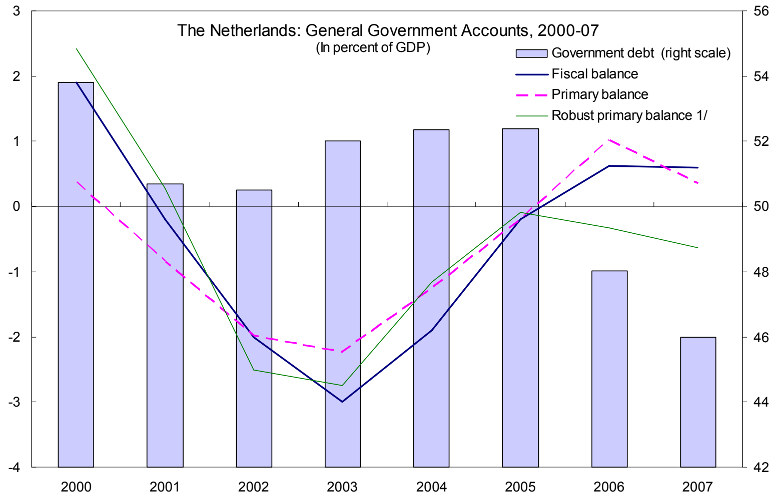


Source:WEO.

Figure 3 shows that the Netherlands has gained overall export market share. Further, a CPB study[1] indicates that, while domestically produced exports have lost market share in recent years, this loss is much reduced if market growth is corrected by including only domestically produced exports and for the double counting due to reexports when calculating the relevant world trade.

Sectoral analysis of Dutch export performance confirms that competitiveness is not a problem, but with signs of erosion. The SIP shows that, in the 2000's, the Netherlands generally preserved its advantage in trend export growth vis-à-vis Germany. But it lost its traditional lead over Germany in exports of manufactured goods, machinery, and transport equipment. Econometric tests also suggest that the Netherlands is more exposed to supply-driven shocks while Germany to demand-driven shocks.

[1] M.C. Mellens, H.G.A. Noordman and J.P. Verbruggen, *Re-exports: international comparison and implications for performance indicators*, CPB Document No. 149, July 2007.



1/ The robust primary balance is defined as the structural balance adjusted for net interest payments and gas revenues.

6. **Long-term fiscal sustainability remains elusive, owing to population aging and its attendant budgetary costs.** The Netherlands is in a comparatively favorable position to deal with this problem, given its relatively benign initial fiscal position. In addition, the existence of a large, fully funded, pension pillar helps mitigate the burden of aging. Nonetheless, its fiscal impact is large (about 7 percent of additional annual expenditures by 2040, mostly on account of healthcare and pension outlays). If not offset by a reduction of aging-related entitlements, or cuts in other spending and revenue increases, this prospective millstone would lead to an unsustainable deterioration in public finances.

7. **The Dutch financial system has proven generally resilient to the turmoil.**

- The regulatory capital ratio of Dutch depository institutions has improved from 11.9 to 13.2 percent (e-o-y) in 2007, but equity capital ratios are comparatively low. Despite some recovery over 2003-06, return on assets remained lackluster and noninterest expenses high in international comparison, although risks—as assessed by commercial banks for purposes of determining capital requirements—are also low. Corporate loans, especially short term, rose rapidly, reflecting strong investment. While home prices held up well, mortgage lending growth fell sharply, reflecting higher interest rates and tighter credit standards under the new Code of Conduct.[1] Tax incentives encourage high loan-to-value (LTV) mortgages, but banks generally maintain separate collateral against them.

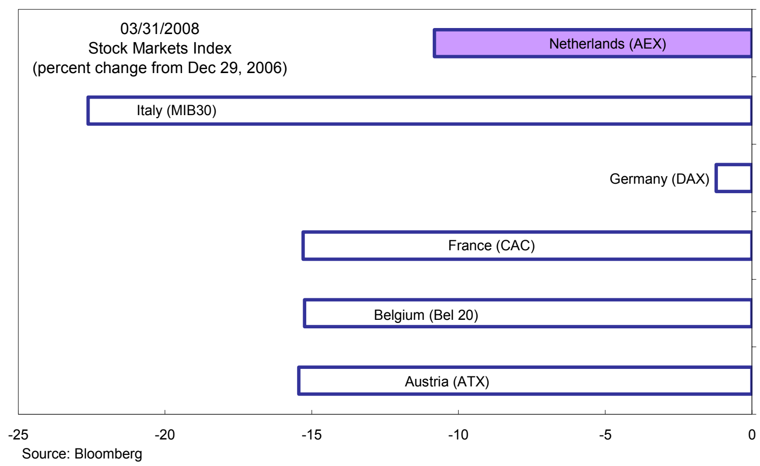
- Despite losses and write-offs of about €7 billion for 2007, the large international banks have generally small and higher-rated U.S. subprime exposure, smaller banks

[1] The 2007 Code intends to limit mortgage debt service to 25–30 percent of borrower income and tightens guidelines to judge affordability and inform consumers about risks.

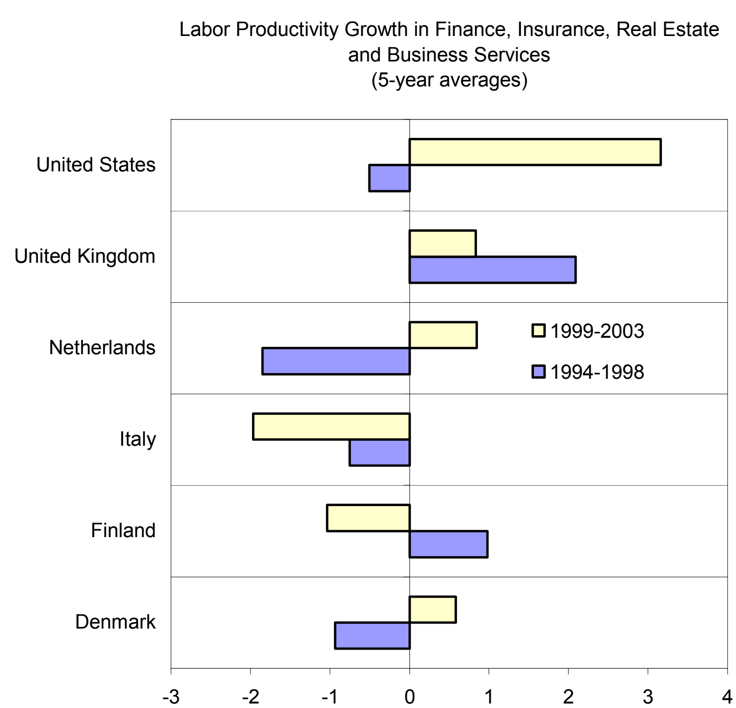
have little or no exposure, and the system has remained profitable. Several affected banks have raised significant new capital, and one major bank that reported higher profits and dividends is implementing a share buyback.

- The average funding ratios in the pension and insurance sectors improved in 2007. Sectoral exposure to subprime loans is low, particularly for insurers.

- The stock market has done better than most in the euro area from end-2006.



8. **Nevertheless, a few pockets of softness and the uncertain impact of the global turmoil warrant caution.** In the short run, losses of major banks and pension funds from subprime loans and other assets could rise. Life insurers face stagnating premia, excess capacity, strong competition, and low margins. In general, risks relating to liquidity, valuation, and recapitalization—although manageable—have increased under disturbed market conditions. While a full-blown credit crunch is unlikely, the latest ECB survey points to a tightening of eurozone lending conditions. In the Netherlands, lending rates have increased by 50-60 basis points for corporate and mortgage loans, though



reflecting changes in ECB policy rates more than spreads. In the longer run, sluggish productivity and low profitability in the Dutch financial sector weigh down on its ability to support growth and adaptation of the economy. The spread of complex products, deepening international integration, high mortgage debt, and rising securitization pose challenges—underlined by the turmoil—about internal risk management and supervision of financial institutions.

II. Outlook

9. **Economic expansion is set to continue, albeit at a lower pace.** Staff projects that output will rise somewhat above 2 percent in 2008. With a large growth carryover from 2007, this implies a rapid within-year deceleration owing to the impact of the global financial turmoil on U.S. and European growth. Consumption is expected to lose speed as lower employment gains should be only partly offset by higher labor compensation. Fixed investment will also slow somewhat, following completion of important infrastructure projects, while the foreign contribution to growth fades. Inflation should rise moderately, above 2 percent, with the output level remaining above potential and wages expected to increase more than productivity amid a tightening labor market. For 2009, further growth deceleration at about 1½ percent is anticipated, owing to the lingering effects of the financial

Netherlands: GDP Growth and Inflation (HICP) Projections, 2008-09
(In percent)

	GDP Growth			Inflation		
	2007	2008	2009	2007	2008	2009
WEO, October 2007	2.6	2.5	2.2	2.0	2.2	2.0
WEO, April 2008	3.5	2.1	1.6	1.6	2.4	1.8
CPB, March 2008	3.5	2.3	1.8	1.6	2.5	2.8
DNB, Dec. 2007	3.2	2.6	2.1	1.6	2.6	3.1
Consensus, Jan 2008	3.5	2.3	2.2	1.6	2.3	2.4

Netherlands: MediumTerm Growth Projections

Average medium-term growth is in line with potential growth (about 2 percent), reflecting a projected pick-up in domestic demand, while the net foreign contribution is expected to stabilize at about 0.7 percent of GDP.

	2009	2010	2011	2012	2013
Growth rates, in percent					
Real GDP	1.6	2.1	2.2	2.2	2.2
Contribution of domestic demand	1.1	1.4	1.5	1.5	1.5
Foreign contribution	0.5	0.6	0.7	0.7	0.7

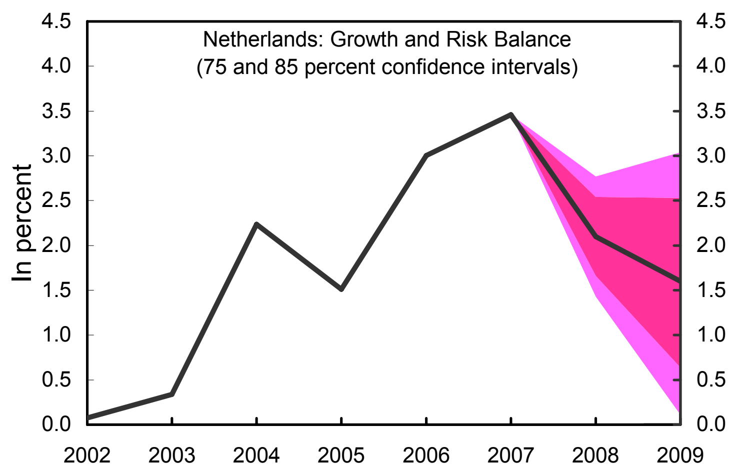
turbulence, with inflation edging just below 2 percent.[2] The authorities' projections were more sanguine on growth for both years, but anticipated markedly higher inflation in 2009 reflecting the tight labor market and the impact of increases in the VAT and excises.

Impact of Financial Market Turmoil on GDP Baseline Projections
(Deviations from baseline projection in percentage points)

	2008	2009
An increase in long-term interest rates of 100 basis points	-0.2	-0.6
A 20 percent decline in equity prices	-0.1	-0.1
A 10 percent decline in average house prices	-0.3	-0.4

10. **Uncertainties regarding the outlook are high, with risks broadly balanced.** Main risks include deviations from the baseline in: (i) lending conditions; (ii) housing and equity prices,[3] that could affect significantly domestic demand, given the strong links between private consumption and stock market developments in the Netherlands; (iii) oil prices; (iv) external demand spillovers; and (v) labor market conditions (the sharp increase in commodity prices with attendant terms-of-trade deterioration may trigger a wage-price spiral that could undermine competitiveness and growth as in the early 2000s). In the current projection, upside and downside outcomes for these risk factors are deemed equally probable, but their dispersion is unusually

Real GDP Growth: Risks to the Forecast



The chart includes the following risks to the projections of growth (2.1 percent in 2008 and 1.6 percent in 2009):
- changes in tightness of financial conditions;
- housing and equity prices;
- variations in oil prices;
- changes in foreign demand;
- variations in the labor market situation.

These risks are weighted by the staff's subjective probability assessment of their occurrence.

[2] During the mission, growth was projected at 2.3 and 1.8 percent in 2008 and 2009 respectively (the comparable figures for inflation were 2.4 and 2.3 percent). Following the latest round of WEO revisions, growth was lowered to 2.1 and 1.6 percent, with inflation at 2.4 and 1.8 percent, respectively for 2008 and 2009.

[3] Baseline projections assume that housing and equity prices will broadly hold steady.

pronounced, in light of uncertainties on the extent of the global financial distress and its impact on consumer and producer confidence, both of which are quite volatile. The exception is the 2009 inflation projection, for which overrun risks prevail.

Netherlands: Spillover Effects of Economic Downturn in the U.S.

A 1 percentage point reduction in U.S. GDP growth is estimated to result in about 1/2 percentage point fall in Dutch GDP growth after 2 years. The main channels of transmission include the direct and indirect trade channels, but also private investment, inflation, the real effective exchange rate, the Dutch stock market index, and outward foreign direct investment.

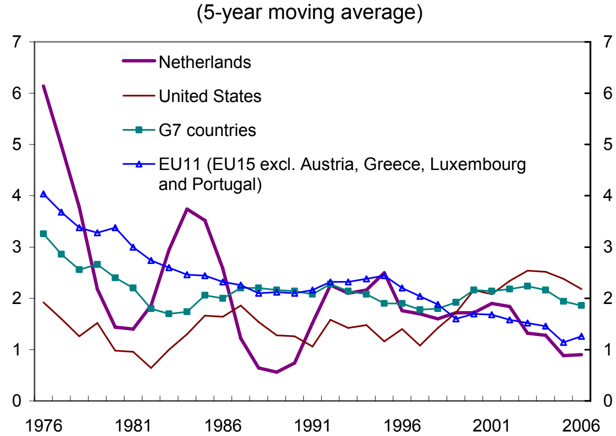
	2008	2009
Relevant world trade	-0.6	-0.8
GDP	-0.2	-0.3
Private consumption	-0.1	-0.2
Exports of goods (excluding energy)	-0.5	-0.6
Imports of goods	-0.4	-0.5
GDP deflator	-0.1	0.0
General government balance	-0.1	-0.1

Source: Fund staff estimates.

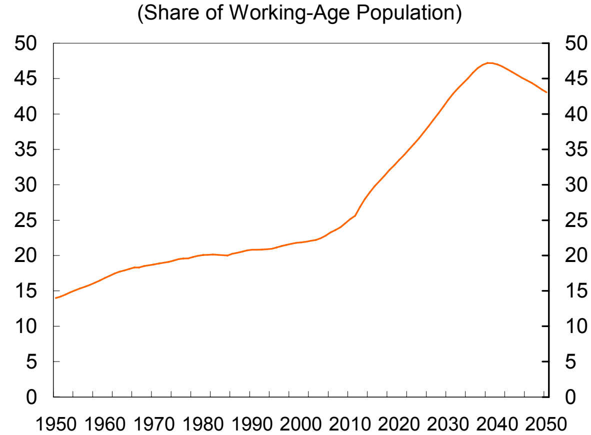
11. **The authorities concurred that external competitiveness is broadly adequate, but noted risks going forward.** They considered that the business sector is in a sound position for profitability and competitiveness, but stressed the danger that buffers may be eroded quickly if wage rises exceed productivity gains, leading to increased unit labor costs. In this context, officials also remarked that appreciation of the euro, if continued, would rapidly exhaust residual competitiveness margins.

12. **One important concern is the risk to longer-term growth and competitiveness posed by rapid aging and sluggish productivity.** The Netherlands experiences declining trend productivity growth, which, despite some recent recovery, remains slower than in other partner economies. Furthermore, imminent population aging will shrink working-age cohorts from early the next decade. Therefore, raising the employment rate and stimulating faster

Hourly Productivity Growth
(5-year moving average)



Elderly Dependency Ratio
(Share of Working-Age Population)



productivity gains will be key for long-term potential growth and competitiveness prospects. Above all, this requires improving the lackluster productivity record of the service sector.

Long-Term Scenario

Prospects for labor force participation/employment and productivity growth imply a significant drop in per capita income growth.

	1995-2000	2000-05	2005-10	2010-20	2020-30	2030-40
Productivity growth 1/	1.7	-1.3	1.3	1.3	1.3	1.3
Demographic contribution 2/	-0.1	-0.2	-0.2	-0.4	-0.5	-0.4
Employment rate contribution 3/	1.9	2.1	1.1	0.7	-0.3	-0.3
GDP per capita growth	3.5	0.7	2.3	1.6	0.4	0.5

Sources: WEO; Central Bureau of Statistics (CBS); Bureau for Economic Policy Analysis (CPB).
1/ GDP per employed. Projections assume a continuation of the most recent trend.
2/ Change in the share of population 20-64 years.
3/ Employed as a share of population 20-64 years.

III. Policy Discussions

13. **Against this background, discussions focused on fiscal policy, structural reform, and financial sector issues.** Specifically:

- adopting tax and public expenditure policies that promote continued economic expansion while ensuring fiscal sustainability;

- reforming labor and product markets to enhance utilization of soon-to-be shrinking human resources and competition;

- maintaining stability of the financial sector—to prevent that global market tensions and rising volatility unleash a crisis of confidence—while raising its efficiency.

A. Fiscal Policy

14. **Staff saw merit in a somewhat tighter fiscal stance in 2008-09.** The authorities' budget plans for both years envisage surpluses of about ½ percent of GDP, which are projected to be exceeded owing mainly to high gas revenues. However, the fiscal balance corrected for the cyclical position, gas proceeds, and net interest payments—namely the "robust" balance—weakens appreciably compared to the 2007 level, pointing to a pro-cyclical stance. Instead, in light of the expected above-potential output and labor market tensions, in the staff's view, some withdrawal of fiscal stimulus would be appropriate—a robust balance outcome higher by ¼-½ percent of GDP in 2008-09. Nonetheless, staff underscored that, were growth to fall significantly short of current projections, automatic fiscal stabilizers should be allowed to operate fully.

15. **The authorities expressed conditional support for the recommendation to err on the side of higher surpluses in budget execution.** Projections point to a sizable revenue overperformance, though owing mainly to cyclical upswing and buoyant gas proceeds. But there are also potential savings associated with underexecution of investment projects financed by the Infrastructure Development Fund and other margins under the expenditure ceilings. Therefore, staff believes that a better-than-planned outturn for the robust balance could be achieved within the existing fiscal framework. The authorities indicated that they too would prefer to realize those savings, but pressures to increase spending, especially for health- and child-care, may prevent them from doing so. In any case, they were determined not to exceed the expenditure ceilings set by the multiannual budget and to ensure that the medium-term surplus objective is attained.

16. **The authorities also acknowledged that their medium-run fiscal plan falls still short of ensuring long-term sustainability.** It targets a structural surplus of 1 percent of GDP by 2011, corresponding to a robust surplus of ¼ percent of GDP, an improvement which reflects the impact of already announced measures over the government's term. Furthermore, such measures will produce additional sustainability-enhancing effects after 2011 equivalent in present value to about ½ percent of GDP. These efforts notwithstanding, in an otherwise "passive" projection, the additional public spending associated with population aging eventually generates ever growing deficits and debt. Authorities and staff concurred that long-term fiscal sustainability requires a robust surplus permanently higher by some 2¼ percent of GDP than in the passive scenario—around 3 percent of GDP in 2011.[4]

General Government Accounts, 2006-2011 1/

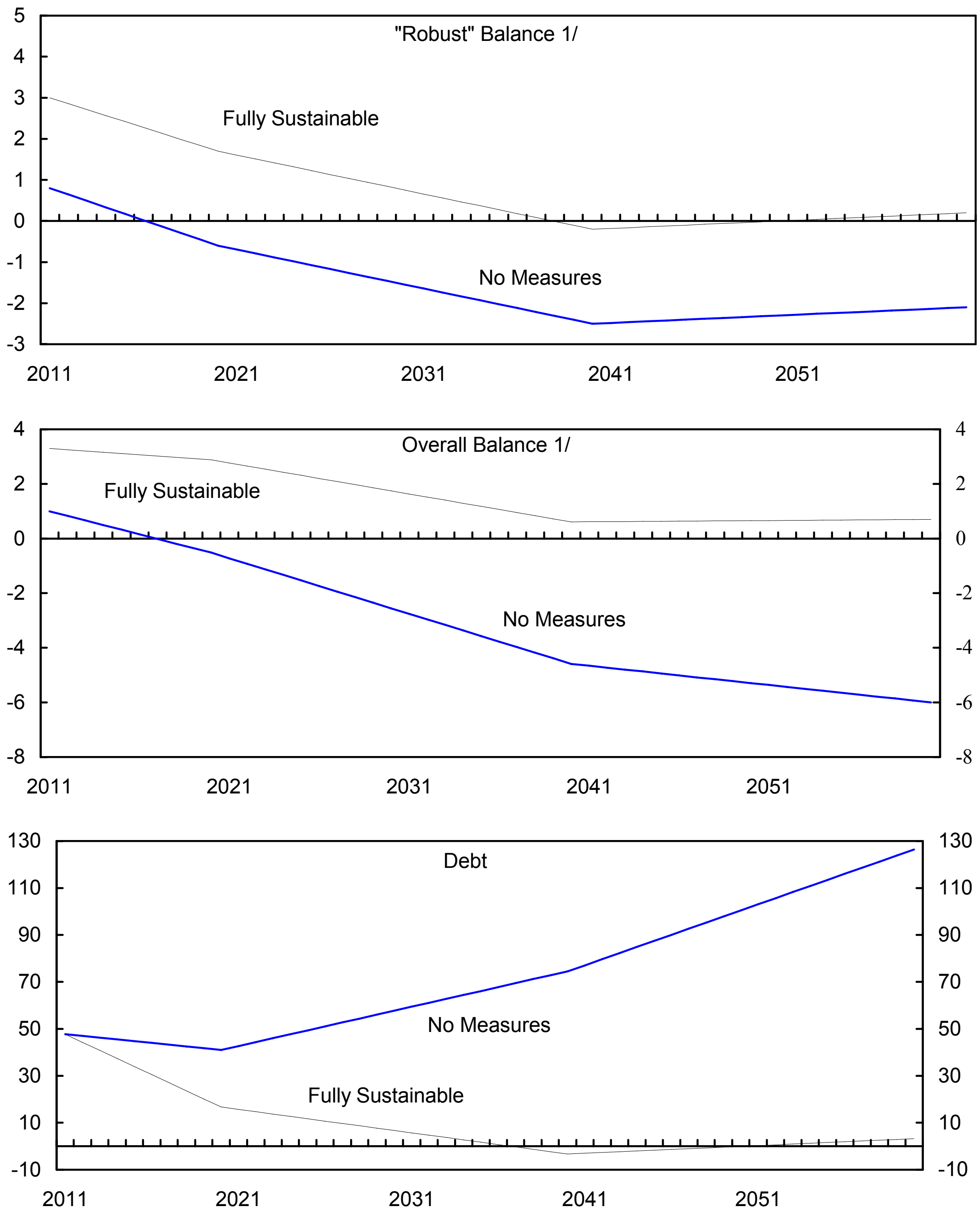
(In percent of GDP)

	2006	2007	2008	2009	2011
Medium-term budget plans					
Fiscal balance	0.6	0.0	0.5	0.6	1.0
Robust (primary) balance	-0.3	-1.0	-0.9	-0.6	0.3
Authorities' projections					
Fiscal balance	0.6	0.6	1.1	1.4	1.0
Robust (primary) balance	-0.3	-0.6	-0.9	-0.7	0.3
Staff recommended scenario					
Fiscal balance	0.6	0.6	1.4	1.8	1.4-1.9
Robust (primary) balance	-0.3	-0.6	-0.6	-0.3	0.5-1.0

1/ The long-term fiscal sustainability entails a fiscal surplus of 3.7 percent of GDP, equivalent to a robust surplus of 3.0 percent of GDP in 2011.

[4] This difference is the "sustainability gap."

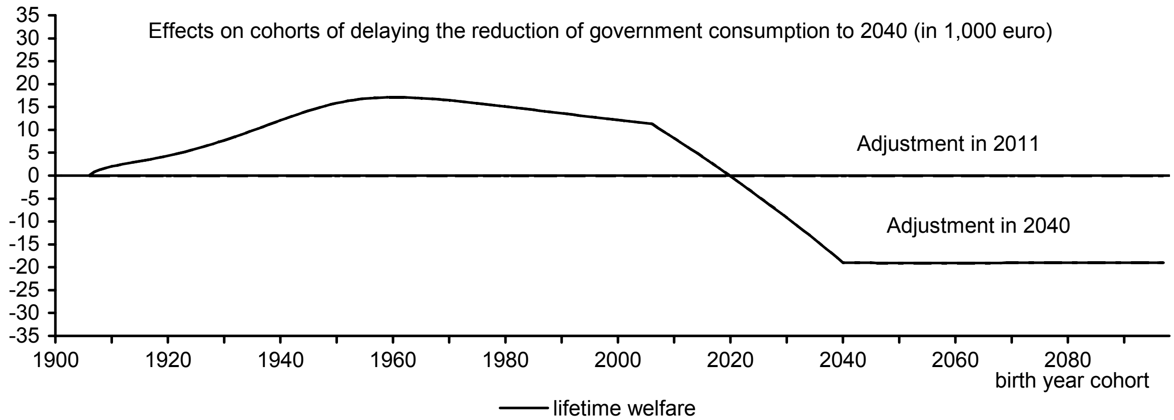
Netherlands: Fiscal Sustainability, 2011-2060
(Percent of GDP)



Source: CPB Discussion Paper No. 61 (2006) and September 2007 update; and staff calculations.
1/ Robust and overall balance "no measures" include in 2011 the present value of the measures already announced with effects after 2011.

17. **Nevertheless, further early progress to cope with the fiscal brunt of aging is difficult.** Staff recommended filling about one-third of the sustainability gap by 2011. Indeed, front-loading the fiscal adjustment is desirable for intergenerational equity and to contain the size of the required tightening. In this connection, given the better-than-budgeted outcome for 2007 and likely overperformance in 2008-09, staff argued that the 2011 robust surplus could be ½-¾ percent of GDP higher than in the authorities' medium-term plan. The authorities did not discount this possibility, but doubted that revenue buoyancy and the margins under the expenditure ceilings could be sustained through 2011. They agreed, however, that, if preserving these margins did not prove feasible, the additional spending ought to support structural reforms that reduce the sustainability gap.

Delaying budgetary adjustment until 2040 will require a tightening of more than 7 percent of GDP to attain sustainability. Furthermore, the costs of the delay for those born after 2040 amount to almost 2 ½ percent of their lifetime income (or 19,000 euros in present value terms).



Source: Figure 7.7 (p. 122). 'Ageing and the sustainability of Dutch public finances' C. van Ewijk, N. Draper, H. ter Rele and E. Westerhout.

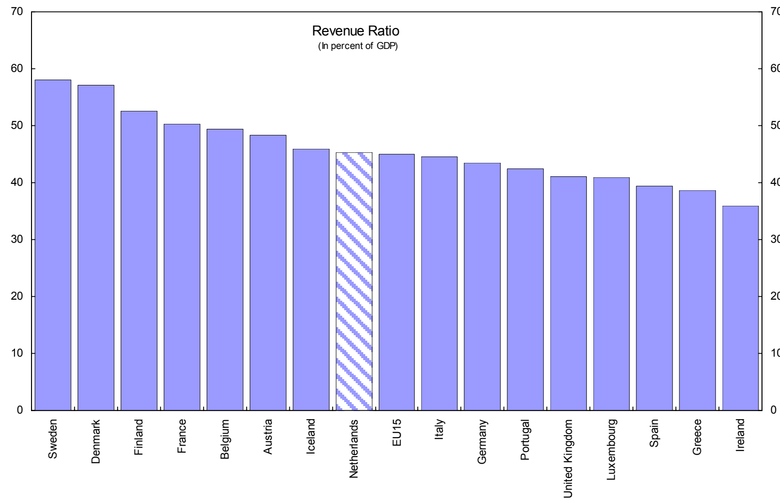
18. **There was agreement that adjustment should focus on expenditure retrenchment or tax base broadening.** The government's economic footprint is already elevated—with the expenditure-to-GDP ratio projected to increase further owing to population aging. Moreover, prevailing tax rates seem to leave little upward room. Indeed, pressures from international tax competition may even suggest cuts in

Marginal Effective Tax Rates for Different Income Groups and Family Types
(In percent)

	2005	2006
2 Adults, 1 income, with child(ren)		
Minimum plus	69.5	60.8
Modal income	70.0	71.0
Twice modal income	59.3	52.8
2 Adults, 2 incomes, with child(ren), income of lowest earner rises		
Minimum plus + half minimum plus	35.3	35.8
Modal income + half modal income	38.0	39.8
Twice modal income + modal income	50.0	48.0

Source: OECD

corporate taxation.[5] Also, labor market reform will likely entail a reduction of marginal tax rates—a stated objective of the new government. In fact, the lifetime marginal income tax burden is quite high for a substantial part of the population, and relatively large tax wedges on earned income discourage work.



Source: OECD.

19. **It was not disputed that further pension reform is key to contain the fiscal costs of aging.** Since life expectancy has increased substantially, the authorities concurred that raising the retirement age from 65 to 67 years, as in some other European countries, was appropriate and would eventually be implemented. A reduction of the old-age related deduction under the income tax would contribute to offset rising aging outlays too. Nevertheless, the current government intended to focus on raising the effective retirement age from the current 60-61 to closer to 65 years of age through tax incentives.

Possible Sustainability-Enhancing Measures and Their Effects 1/

	Sustainability Effect 2/
Increase of retirement age	0.6
Gradual abolition of old-age allowance in income tax	0.7
Reduction of cost of health care	0.7
Increasing labor participation (Shortening of WW to 1.5 years) 3/	0.2
Changing the tax treatment of owner-occupied homes	0.2
Efficiency of other expenditures	0.1

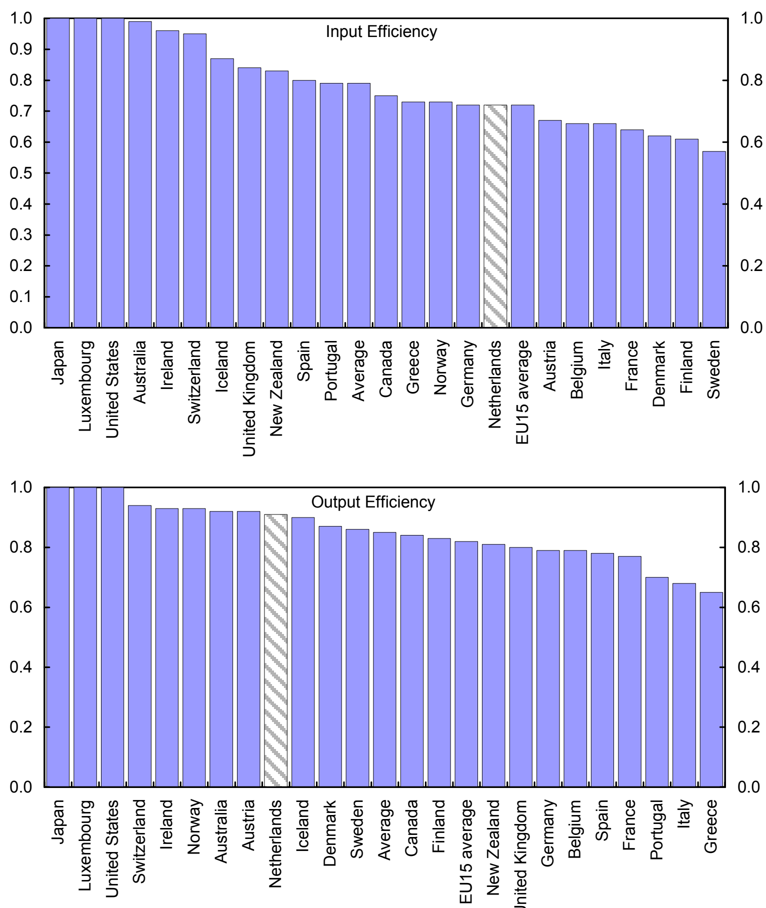
1/ Based on CPB calculations.
2/ In percent of GDP; a positive value implies a reduction in the sustainability gap.
3/ WW is the unemployment benefit.

20. **The authorities viewed savings in healthcare as a significant contributor to longer-term fiscal sustainability.** It was noted that most of the projected surge in healthcare spending is due not to demographic changes, but to expensive advances in medical technology and real income growth (given high income elasticity of health-services demand). Staff argued that an increase in user fees could moderate healthcare demand growth. The authorities objected that such a step could overburden the chronically ill or prove administratively cumbersome if designed to avoid this problem. They believed that tighter definition of entitlements in long-term care could spawn significant savings in an area that had not been touched by the 2006 reform.

[5] SIP estimates suggest a negative impact on corporate taxation of ½–1 percent of GDP, depending, inter alia, on the corporate tax rate differential with new EU members.

21. **Some scope to reduce unemployment-benefit and other expenditures was also identified.** Though cut from 60 to 38 months in 2006, maximum unemployment benefit duration remains high by international standards. Staff suggested lowering it to 18 months, a period which would remain sufficiently long to support job search and simultaneously tend to raise labor participation. The authorities stated that a gradual decrease was in the longer run likely, but in the meantime they would concentrate on strengthening activation of the unemployed. Staff then noted that, according to some studies, in the Netherlands efficiency gains of roughly 20 percent may be possible in public administration, education, and infrastructure provision, when compared with best OECD practice. Thus, significant savings could be realized without jeopardizing the provision of services. The authorities pointed to ongoing efforts to strengthen efficiency through targeted reduction of public employment and diffusion of information technology.

Public Sector Efficiency Measures, 2000 1/

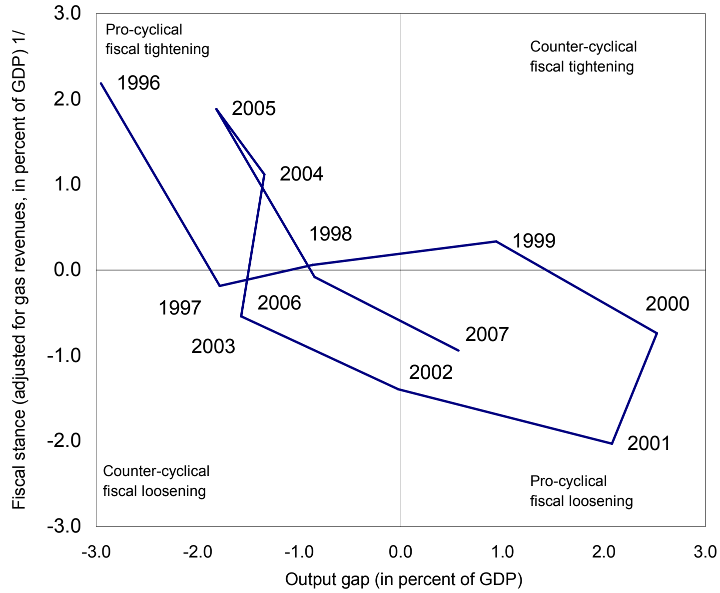


Source: Afonso, Schuknecht, and Tanzi (2005).

1/ Production frontier analysis. Measured relative to the most efficient country (with a score of 1.0), the input efficiency indicates how much less input a country could use to achieve its current output (e.g., 0.6 indicates that it could achieve the same output with only 60 percent of current inputs); the output efficiency indicates how much less output a country is producing (e.g., 0.8 indicates that it is producing only 80 percent of output with the same input as the most efficient country). Input is public expenditure as a percent of GDP; output is a composite public sector performance indicator comprising seven public goods and services.

22. **Officials were open to refinements of the fiscal framework to reduce procyclicality, thereby facilitating budgetary discipline and long-term sustainability.** In line with the 2006 Fiscal ROSC—that gave high marks to the Dutch budgetary system and several recommendations whereof have been implemented—staff favored buttressing the role of automatic stabilizers. Specifically, it proposed that: (i) all tax expenditures (including mortgage interest deductibility and the tax exemption on pension payments) be reported in the budget and, if feasible, included in the expenditure ceilings; and (ii) unemployment benefits be excluded from the ceilings. The authorities confirmed their determination to strengthen transparency of tax expenditures and would consider options to eliminate the cyclical component of unemployment benefits from the spending ceilings.

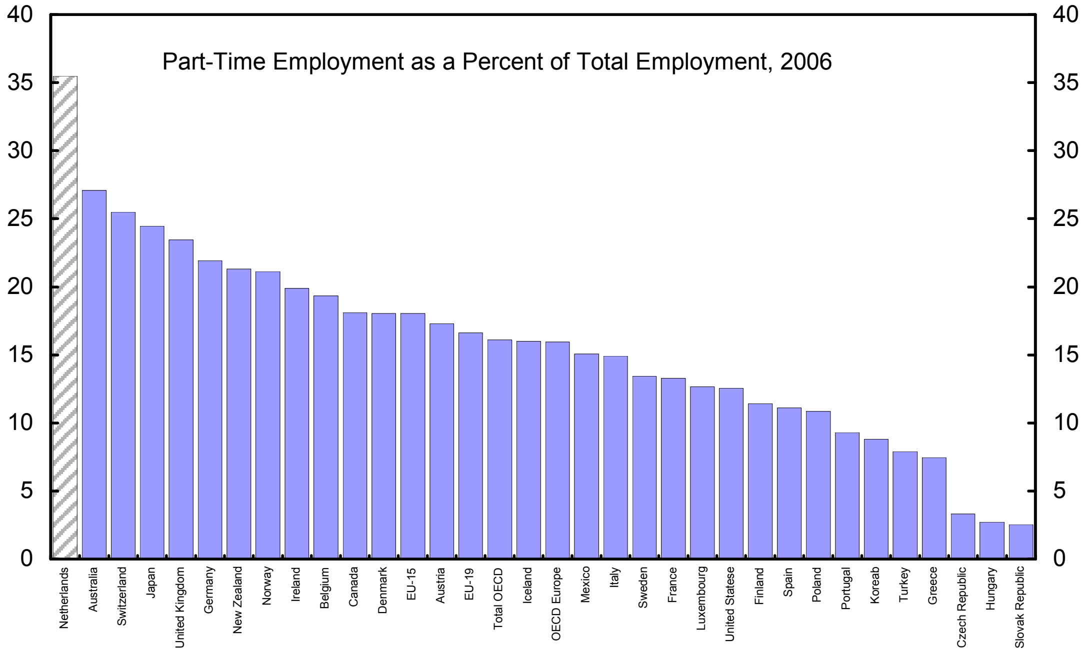
The risk of procyclical fiscal policies is high in the Netherlands, also complicating the achievement of sustainability. Both the deviation of the actual budget deficit from its structural level and the sensitivity of the balance to the output gap are high in international comparison. In part, this relates to the tax deductability of mortgage interest and pension contributions to the extensive second pillar pension system, both of which are procyclical.

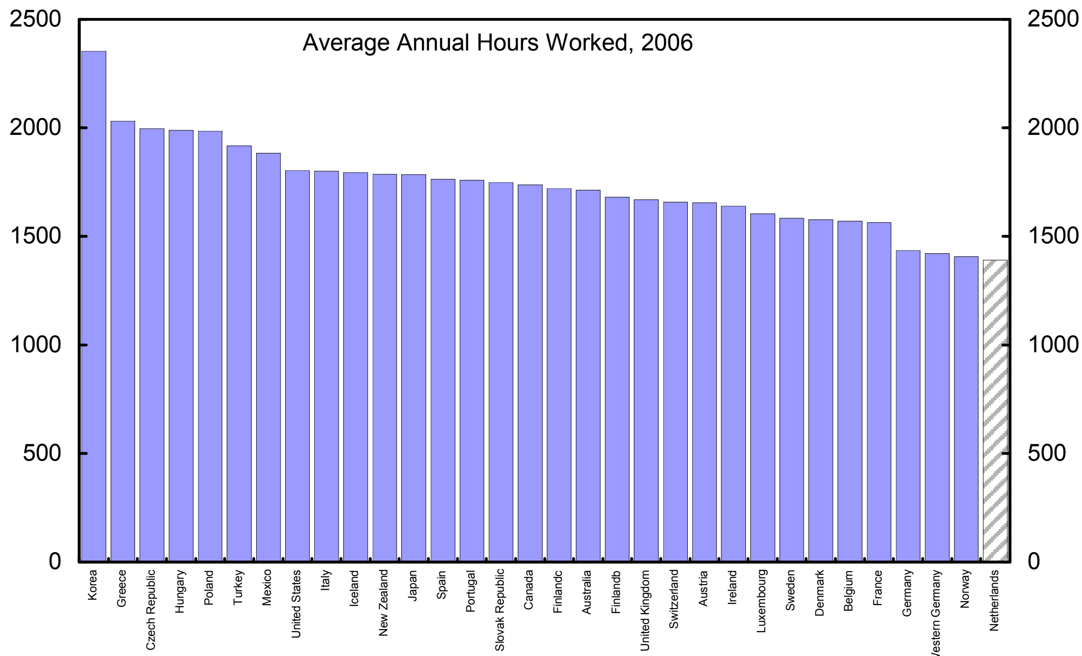


1/ Fiscal stance is measured by the change in the cyclically adjusted primary balance excluding natural gas revenues.

B. Structural Policies

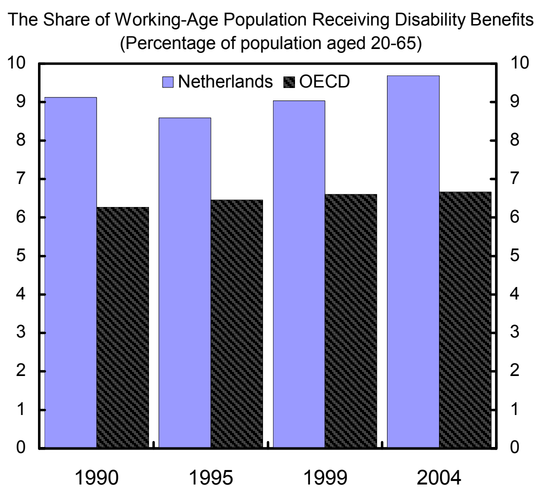
23. **The view prevailed that structural advances are slowing down** (Table 5). This was the result of "reform fatigue" after the bold steps taken in the last few years as well as of the need to take stock of the impact of recent reforms before launching new ones. In addition, dissensions in the governing coalition prevented action in some areas like EPL. Nonetheless, the authorities have also established a commission charged with identifying further reform measures to invigorate the labor market. It will report to the government by mid-2008.


Part-Time Employment as a Percent of Total Employment, 2006
0
5
10
15
20
25
30
35
40
Netherlands
Australia
Switzerland
Japan
United Kingdom
Germany
New Zealand
Norway
Ireland
Belgium
Canada
Denmark
EU-15
Austria
EU-19
Total OECD
Iceland
OECD Europe
Mexico
Italy
Sweden
France
Luxembourg
United Statese
Finland
Spain
Poland
Portugal
Koreab
Turkey
Greece
Czech Republic
Hungary
Slovak Republic

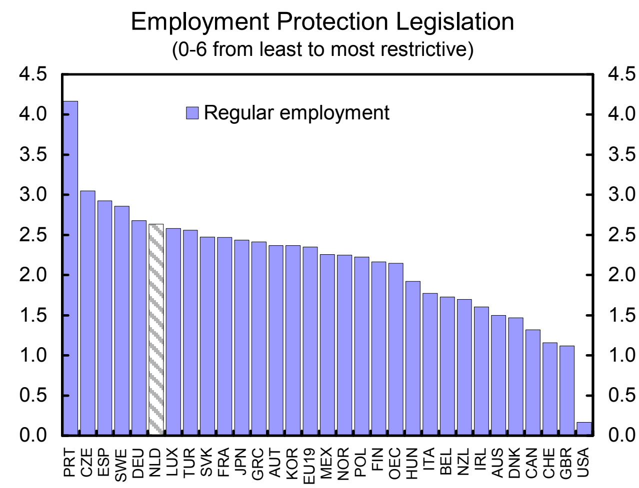

Average Annual Hours Worked, 2006
0
500
1000
1500
2000
2500
Korea
Greece
Czech Republic
Hungary
Poland
Turkey
Mexico
United States
Italy
Iceland
New Zealand
Japan
Spain
Portugal
Slovak Republic
Canada
Finlandc
Australia
Finlandb
United Kingdom
Switzerland
Austria
Ireland
Luxembourg
Sweden
Denmark
Belgium
France
Germany
Western Germany
Norway
Netherlands

Source: OECD.

24. **The authorities concurred that reforms of the tax system, social entitlements, and employment protection are key to stimulate employment.** Given low labor utilization and to promote female and elderly employment, they enacted a gradual elimination of the imputation of the general tax credit to the primary worker and are planning targeted increases of tax credits for workers aged 57 and above, while exempting pensioners that have worked between ages 63-65 from the new levy for people over 65. Steps are also under consideration to limit use of the disability scheme for the young. Staff endorsed these measures, but argued that further action would be desirable, especially in light of the impending aging. Various proposals, in line with OECD recommendations, were well received in principle, but the authorities emphasized that their fiscal costs or the need to reach agreement with social partners meant that they could not be introduced soon (Table 6).

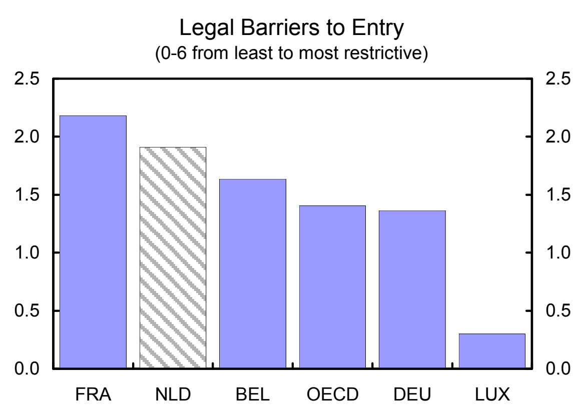


Source: OECD, *Going for Growth 2007.*



Source: OECD *Going for Growth 2007.*

25. **While continuing to boost competition and innovation in product markets, officials approached liberalization cautiously.** The authorities' innovation pillar should facilitate the adoption of new technologies. The recent strengthening of the competition authority's (NMa) investigative powers should kindle competition and thus productivity. Finally, the government intends to reduce red tape by an additional 25 percent. However, staff noted that the Netherlands is an outlier in high barriers to entrepreneurship, partly due to burdensome licensing requirements, and only achieves middling rank in product market regulation, reflecting also strict zoning regulations and stringent shop opening hours. Staff advocated



Source: OECD *Going for Growth 2007*

greater liberalization. The authorities stressed that it had to be gradual and its impact assessed at each step to prevent deterioration in the quality of urban living.

26. **The authorities support overseas development assistance (ODA), continuing to exceed the United Nations' target of 0.7 percent of GNI.**

C. Financial Sector

27. **The authorities confirmed the overall robustness of the Dutch financial system, but admitted several concerns.** These include: (i) the impact of prolonged turmoil on key banks; (ii) weaknesses in ratings and regulatory reliance thereon; (iii) valuation and risk management of structured products; (iv) difficulties in raising liquidity or capital under disturbed market conditions, though the authorities did not believe that Dutch banks had particular problems in this regard; and (v) quality of disclosure of complex products. The authorities are actively participating in international fora to address these problems. While low risk-weighting and higher leverage have boosted the regulatory capital ratio and return on equity, the authorities recognized that banks' return on assets has been one of the lowest among peers. They also conceded that life insurers suffer from languishing premia and low margins, while the transparency of unit-linked insurance products was an issue. Finally, the pension funds' cover ratio can be quite volatile (it dropped 20 percentage points in the first two months of 2008) given both the large duration mismatch and asset price volatility.

28. **Based on recent stress tests, supervisors concluded that banks can withstand current global turmoil, but pension funds would suffer more.**[6] The regulatory capital ratio would decline by 1.4 percent. Though not similarly tested, insurers would be less vulnerable due to negligible exposure to subprime and other low-rated assets, while, as mentioned, the pension funding ratio is quite sensitive to changes in interest rates or asset prices. Regarding liquidity concerns, Dutch banks consolidate their conduits under IFRS, and accordingly their liquidity management extends to the needs of such conduits. Following the global turmoil, the central bank (DNB) is monitoring bank liquidity intensively as well as reassessing the banks' internal risk management, use of ratings, internal models, and early warning system.

29. **The authorities expressed satisfaction with progress of the ABN-AMRO takeover, while stressing managerial and supervisory challenges.** They were generally pleased about cooperation with fellow supervisors and progress made by the consortium—Fortis, Royal Bank of Scotland (RBS), Santander. DNB and the Financial Supervisory Agency (FSA) have agreed that DNB will remain the consolidated supervisor of ABN-

---

[6] U.S. and euro zone growth rates fall to 0 and 1 percent in 2008, seizure in various credit markets, return of all structured products to originators, zero growth in European housing market, and a 40 percent USD depreciation.

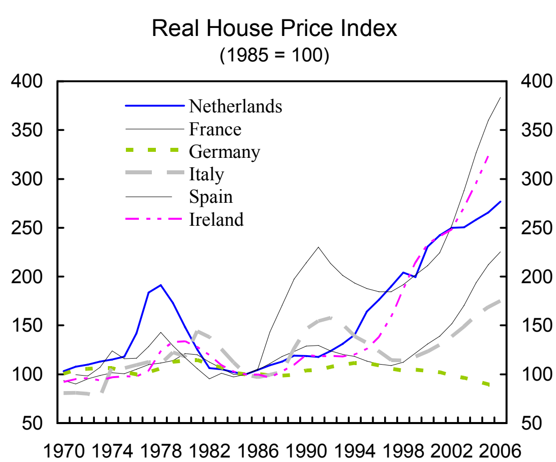
AMRO, while FSA that of RBS Group. The Dutch and Belgian supervisors already have a memorandum of understanding (MOU) regarding Fortis, which will be reviewed in light of the ABN-AMRO transaction and the increased share of Dutch activities of Fortis. Staff welcomed these steps. All concurred that this takeover underlines the difficulties of supervising large EU-wide financial institutions by national regulators and the burden of complying with multiple regulations. Accordingly, staff highlighted the importance of reviewing all existing MOUs in particular to clarify the responsibility for crisis management and lending of last resort.

30. **Supervisors maintained that mortgages carry low risks, but high mortgage debt, risk concentration, house prices, and securitization require careful watch.**

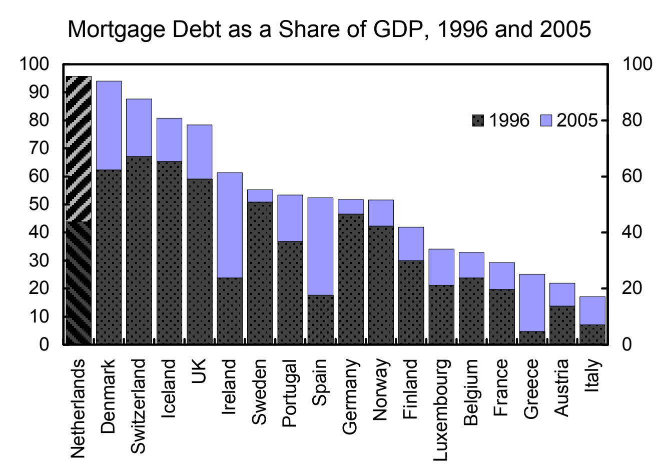
- Staff questioned the very large and increasing LTV ratio of mortgages (averaging 114 percent in 2007) and the predominance of bullet loans. The authorities acknowledged these problems, but attributed them to high tax incentives, and pointed out that systemic risk is reduced by build-up of collateral in mortgage-linked insurance or savings accounts. Still, they recognized that risks are concentrated in new mortgages with high LTV ratios, especially for young workers with low incomes. In this regard, the authorities conceded that the voluntary code of conduct has not limited LTV ratios as much as expected, primarily due to high competition.

- While aware of the large declines in housing markets in the U.S., U.K., and Spain, the authorities felt that limited land supply and generous mortgage interest deductibility reduce the likelihood of sharp house price corrections in the Netherlands. Staff and authorities concurred that, based on existing regulatory constraints, which tend to cause higher prices, house overvaluation is only slight (Box 2).

- Officials accepted that mortgage interest deductibility results in high housing prices, lower affordability—especially for younger workers—and greater vulnerability to interest rate shocks. Mortgage debt at 95 percent of GDP is much higher than in most mature markets, and large build-up of mortgage-related collateral distorts investment.



Source: Bank for International Settlements.



Source: European Mortgage Federation.
1/ Initial data for Portugal are 1999, and for Austria are 2001.

Box 2. House Prices in the Netherlands

Some raw indicators raise concerns that housing prices deviate from fundamentals in the Netherlands. Both the price-to-income and the price-to-rent ratios have increased continuously throughout the 1990s and have remained at high levels thereafter. Nevertheless, these indicators do not consider the influence of other fundamentals that may also have changed. Hence, a more detailed analysis based on econometric techniques is appropriate.

In this regard, in a cross-country exercise, the Spring 2008 WEO points to a sizable house price gap. WEO estimates a gap of about 30 percent between actual increases in Dutch house prices over the last decade and those that can be explained by common fundamentals. At the same time, the WEO assessment is based on a house pricing model aimed at cross-country comparisons, which necessarily takes limited account of country-specific factors.

However, most Dutch-specific econometric studies suggest a small or no gap. For example, staff work for the 2005 and 2006 Article IV consultations[1] found house prices to be approximately in line with fundamentals. The authorities' own analysis broadly supports this conclusion.[2] An OECD study[3] of the probability of having reached a turning point in various housing markets indicates that it is very small in the Netherlands (as opposed to several other countries, including the U.S.).

The different results may be due to the choice of the base period, institutional factors, and measurement of disposable income.

- In general, the house price level in a given year must be set as the base from which price changes explained by the respective models are compared to actual changes. If the latter exceed the former, a gap results. Because of its cross country nature, WEO, for all countries in its sample, selects 1997 as the base year. However, this may not have been an "equilibrium" from a Dutch perspective. For example, the price-to-income ratio in 1997 was some 12-13 percent below the long-term average. Accordingly, models which take periods closer to the average experience as a base interpret the fast growth of house prices in the second half of the 1990s as catching-up towards equilibrium.

- Institutional features also matter for house prices. In the Netherlands, these include strict zoning regulations that limit housing supply and generous mortgage interest deductibility from income taxes that drives up demand, both of which tend to raise the house equilibrium price. Models which incorporate good estimates of the initial equilibrium and are better specified overall will reflect these institutional factors more accurately.

- Housing prices are modeled by WEO as a function of, among other variables, disposable income per capita. If total disposable income were used, the size of the gap shrinks. Indeed, the latter measure captures not only the increase in household incomes, but also the rise in the number of households, which is important in the Netherlands because an increasing proportion of single-person households has contributed substantially to housing demand.

---

[1] Country Reports No. 05/225 and No. 06/284.

[2] J. Verbruggen et al., Welke factoren bepalen de ontwikkeling van de huizenprijs in Nederland? CPB Document No. 81, 2005. The 2005 study found evidence of a possible 10 percent overvaluation in 2003, but its recent update (CPB Memorandum No. 200, April 22, 2008) concludes that by 2007 there was no overvaluation.

[3] P. van den Noord, Are house prices nearing a peak? A Probit analysis for 17 OECD countries, ECO/WKP(2006) 16, No.488.

- With large mortgage debt, securitization has grown rapidly. The authorities agreed that this calls, inter alia, for high origination standards, good rating models, and supervisory vigilance about liquidity and capital requirements for securitized assets.

IV. Staff Appraisal

31. **The Netherlands is well equipped to deal with the global financial crisis, but the outlook is unusually uncertain.** Recent growth and inflation performance are excellent in the EU context. External competitiveness is adequate, the government budget is in surplus, and financial sector supervision is strong and well designed. Thus, despite the financial turmoil and U.S. slowdown, staff expects real GDP to continue expanding above the EU average in the near term, with output remaining above potential and persisting labor market tightness. Risk factors range from lending, housing, and equity market conditions, to oil prices, external demand, and labor market tensions. Staff regards current growth projections as conservative and thus these risks are broadly balanced, but with fatter-than-ordinary tails.

32. **Though conjunctural indicators are positive, the challenges of an aging population and low productivity growth loom large.** Despite a large, fully-funded second pension pillar, population aging is anticipated to create large fiscal burdens, including for growing health care costs. Productivity growth in the Netherlands, despite some recent recovery, remains slower than in partner economies. Further, imminent population aging will shrink the working-age cohorts from early the next decade. Thus, raising the employment rate and stimulating faster productivity gains will be essential for long-term potential growth, competitiveness, and fiscal sustainability.

33. **A somewhat tighter fiscal stance is advisable from both long-term fiscal sustainability and cyclical perspectives.** To stabilize net government debt despite the budgetary costs of impending aging, the robust balance must improve by about 2¼ percent of GDP relative to the path implicit in the authorities' medium-term policies. Early reduction of the sustainability gap would limit the size of the needed fiscal correction and distribute the burden more equitably across generations. Under current growth projections, modest withdrawal of fiscal stimulus (broadly locking in the overperformance realized in 2007) is also called for because economic activity is somewhat above potential and the labor market tight. Maintaining a margin under the expenditure ceilings set in the medium-term budget framework could contribute greatly to this outcome. However, if growth turned markedly lower than projected, automatic stabilizers should be allowed to operate fully.

34. **With relatively large tax wedges on labor income, fiscal adjustment should focus on spending restraint and tax base broadening.** Otherwise, expenditures would rise rapidly owing to aging, while international tax competition puts pressure to lower corporate tax rates. Savings require: (i) further pension reform; (ii) additional efforts to rein in health care expenditures; (iii) enhancements in public expenditure efficiency, building on existing efforts, to curtail expenditure growth without endangering services; and (iv) tighter

unemployment benefits. More transparency of tax expenditures would further strengthen budgetary discipline and reduce residual elements of procyclicality in the fiscal framework.

35. **Efforts to increase employment are crucial to ease growing labor shortages, support growth, and address the impact of population aging.** Despite relatively high employment rates, low hours worked attest to limited labor utilization. Reforms of the tax system, social entitlements, and employment protection, supported by enhanced activation strategies, are needed to stimulate employment. In particular, reducing the high effective marginal tax rates on second family earners could promote more female employment, while targeted tax incentives could induce elderly participation. Stricter enforcement of work availability requirements, and tightening reassessment of disability status to those aged 45 years and over would lower the share of working-age population receiving social entitlements. Strict EPL for regular employment ought to be liberalized and a funded severance pay system introduced to enhance labor mobility.

36. **Further liberalization would be useful to promote productivity growth.** The authorities' "innovation pillar" and additional reductions in red tape are welcome, but barriers to entrepreneurship and product market regulation remain relatively high. Careful liberalization, including of zoning regulations and rigid shop opening hours, would favor emergence of more firms and greater use of information and communications technologies.

37. **The Dutch financial system is healthy, but with scope to improve its robustness.** It is well poised to weather the global turmoil, thanks to strong initial conditions and good supervision.

- However, banks must boost equity capital and profitability and ameliorate cost efficiency, transparency of complex products, and investor relations to meet conjunctural and structural challenges. The Dutch contribution and leadership in international efforts to implement the lessons from the ongoing crisis concerning ratings, valuation, liquidity, risk management and fine-tuning of capital and other prudential regulation are welcome in this regard. The insurance sector is well-regulated, but has to consolidate and improve margins to deal with global competition and excess capacity. DNB stress testing is of high international standards, but needs to adapt to novel risks (including difficulties in raising capital and liquidity), rapid rating migration, more adverse asset valuations, and incorporate the insurance sector fully.

- For mortgages, regulatory action to reduce high LTV ratios, better measurement of related collateral, and fine-tuning capital requirements for loans with different risk would be useful. Gradual removal of mortgage interest deductibility would lower households' vulnerability to price swings and interest rate shocks. Rapidly growing securitization calls for vigilance about the adequacy of origination standards, rating models, liquidity, and capital requirements for securitized assets.

38. **It is recommended that the next Article IV consultation with the Netherlands remains on the 12-month cycle.**

Table 1 Netherlands: Basic Data

Land area (20067	41.5 thousand sq. km.	
Population (2007)	16.4 million	
Population characteristics and health:		
Life expectancy at birth (2006)	76.4 (male), 81.7 (female)	
Fertility rate (2006)	1.7 children/woman	
Infant mortality rate (2006)	4.96 per 1,000 live births	
Population per sq. km. of land area (2006)	483 persons	
National accounts 2007	(In billions of euros)	(In percent of GDP)
Private consumption	263.2	47.0
Public consumption	141.3	25.3
Gross fixed investment	111.6	19.9
Stockbuilding	-1.2	-0.2
Exports of goods and nonfactor services	421.3	75.3
Imports of goods and nonfactor services	376.6	67.3
Nominal GDP (at market prices)	559.5	100.0

						Est.	Proj.	Proj.
	2002	2003	2004	2005	2006	2007	2008	2009
	(Annual percentage change; unless otherwise indicated)							
National accounts (constant prices)								
Private consumption	0.9	-0.2	1.0	0.7	-0.8 1/	2.1	1.9	1.3
Public consumption	3.3	2.9	-0.1	--	9.4 1/	2.9	1.7	1.5
Gross fixed investment	-4.5	-1.5	-1.6	3.0	7.2	4.9	2.5	0.2
Total domestic demand	-0.4	0.4	0.6	0.9	3.4	2.6	2.3	1.2
Exports of goods and nonfactor services	0.9	1.5	7.9	5.9	7.0	6.4	4.2	3.3
Imports of goods and nonfactor services	0.3	1.8	5.7	5.5	8.1	5.6	4.4	3.0
Net foreign balance 2/	0.5	-0.1	1.9	0.7	-0.2	1.1	0.2	0.5
Gross domestic product	0.1	0.3	2.2	1.5	3.0	3.5	2.1	1.6
Output gap (in percent of potential output)	--	-1.6	-1.3	-1.8	-0.8	0.6	0.7	0.2
Prices, wages, and employment								
Consumer price index (HICP)	3.8	2.2	1.4	1.5	1.7	1.6	2.4	1.8
GDP deflator	3.8	2.2	0.7	2.1	1.9	1.8	2.1	2.1
Hourly compensation (manufacturing)	3.7	2.7	1.6	0.9	1.8	2.0	2.6	2.6
Unit labor costs (manufacturing)	2.8	1.9	-1.5	-0.8	-0.5	0.2	1.1	1.4
Employment	0.4	-0.6	-1.4	-0.4	1.5	1.3	1.3	0.7
Unemployment rate (in percent)	2.9	4.1	4.9	5.0	4.1	3.4	3.0	3.0
Personal sector								
Real disposable income	-0.2	-0.3	2.2	0.2	-1.3 1/	3.0	1.2	-8.4
Household savings ratio 3/	6.5	6.3	7.8	6.7	5.6	6.4	5.8	5.8
External trade								
Exports of goods, volume	1.0	7.4	7.0	6.3	7.4	7.5	5.1	4.0
Imports of goods, volume	3.2	2.3	7.4	6.1	7.6	7.4	7.3	3.5
Terms of trade	1.5	0.8	-0.4	-0.1	-1.4	-0.9	0.9	-1.6
Merchandise balance (percent of GDP)	4.2	6.8	6.7	7.1	6.7	6.6	6.2	5.7
Current account balance (percent of GDP)	2.5	5.5	7.5	7.2	8.3	6.6	5.9	5.6
Public sector accounts (percent of GDP)								
Revenue	43.9	43.9	44.2	45.0	46.9 1/	46.8	47.5	47.3
Expenditure	45.9	46.9	46.1	45.2	46.2 1/	46.2	46.4	45.9
General government balance	-2.0	-3.0	-1.9	-0.2	0.6	0.6	1.1	1.4
Structural balance 4/	-2.0	-2.2	-1.2	-0.2	1.0	0.4	0.7	1.3
Primary balance	0.8	-0.4	0.6	2.2	2.8	2.1	3.2	3.4
Structural primary balance 4/	0.8	0.4	1.3	2.2	3.2	2.6	2.8	3.3
General government gross debt	50.5	52.0	52.4	52.4	48.0	46.0	43.6	40.7

Sources: Dutch official publications; IMF, IFS; and IMF staff estimates.

1/ The introduction of the new health insurance scheme in 2006 caused a significant shift in health care expenditure from private to public consumption, thereby lowering private and raising public consumption growth without changing overall GDP. In a related vein, government revenues rose and private disposable income fell, without affecting the financial position of the public sector or households net terms. This is because public expenditure for health care also rose, while the fall in private disposable income is offset by a similar fall in private health consumption, which is now taken care of in the public domain.

2/ Contribution to GDP growth.

3/ In percent of disposable income.

4/ For 2002, the purchase of gas rights from DSM (0.3 percent of GDP) is excluded.

Table 2. Netherlands: General Government Accounts, 2002–09

(In percent of GDP)

	2002	2003	2004	2005	2006	2007 Est.	2008 Proj.	2009 Proj.
Revenues	43.9	43.9	44.2	45.0	46.9	46.8	47.5	47.3
Tax revenues and social security contributions	37.8	37.4	37.5	37.9	39.5	39.6	40.2	40.2
Tax revenues	24.5	23.6	23.6	24.8	25.3	25.8	26.5	26.6
Social security contributions	13.3	13.8	13.9	13.1	14.2	13.8	13.7	13.6
Nontax revenues	6.2	6.5	6.7	7.1	7.4	7.2	7.3	7.1
Expenditure	45.9	46.9	46.1	45.2	46.2	46.2	46.4	45.9
Direct expenditure	28.1	29.2	28.6	28.2	29.6	29.6	29.5	29.6
Compensation of employees	9.8	10.1	10.0	9.7	9.4	9.4	9.5	9.5
Goods and services (excluding capital formation)	7.0	7.3	7.2	7.1	7.1	7.0	7.0	6.9
Fixed capital formation	3.5	3.6	3.2	3.3	3.3	3.2	3.2	3.2
Social benefits in kind	7.8	8.2	8.2	8.1	9.8	10.0	9.9	10.0
Transfers	15.0	15.2	15.0	14.5	14.4	14.4	14.8	14.3
Subsidies (including EU)	1.8	1.7	1.7	1.5	1.4	1.6	1.6	1.6
Other transfers	13.2	13.5	13.3	13.0	13.0	12.8	13.2	12.7
Households	10.6	10.9	10.7	10.3	10.4	10.1	10.3	10.2
Corporations	0.5	0.5	0.4	0.3	0.2	0.4	0.4	0.4
Rest of the world	2.1	2.1	2.2	2.4	2.4	2.3	2.5	2.0
Interest	2.8	2.6	2.5	2.4	2.2	2.2	2.1	2.0
Fiscal balance	-2.0	-3.0	-1.9	-0.2	0.6	0.6	1.1	1.4
Memorandum items:								
Primary balance	0.8	-0.4	0.6	2.2	2.8	2.1	3.2	3.4
Structural balance (in percent of GDP) 2/	-2.0	-2.2	-1.2	-0.2	1.0	0.4	0.7	1.3
Robust primary balance (in percent of GDP) 3/ 4/	-2.5	-2.7	-1.2	-0.1	-0.3	-0.6	-0.9	-0.7
Output gap	0.0	-1.6	-1.3	-1.8	-0.8	0.6	0.7	0.2
Nominal expenditure growth (in percent) 3/	5.5	4.7	1.3	1.3	7.4	4.9	4.9	2.6
Real expenditure growth (in percent) 3/	2.3	2.5	0.5	-0.5	5.5	2.5	2.5	0.8

Sources: The Netherlands' Bureau for Economic Policy Analysis (CPB), Ministry of Finance, and Fund staff calculations and estimates.

1/ The introduction of the new healthcare system in 2006 did not affect the overall balance, but permanently increased both revenue and expenditure by 1.6 percentage points of GDP.

2/ The calculation of the structural balance is based on the standard methodology which uses fixed elasticities with respect to GDP. Biases can occur, in particular in the context of asset price boom and busts (as discussed for the Netherlands in Country Report No. 04/301).

3/ The increase in expenditure growth in 2006 largely reflects the introduction of the new health care system, as in footnote 1.

4/ The robust primary balance is defined as the structural balance adjusted for net interest payments and gas revenues.

Table 3. Netherlands: The Core Set of Financial Soundness Indicators, 1998-2006

(In percent; unless otherwise indicated)

Indicator	1998	1999	2000	2001	2002	2003	2004	2005	2006
Deposit-taking institutions									
Regulatory capital-to-risk-weighted assets	11.8	11.6	11.6	11.7	12.0	12.3	12.3	12.6	11.9
Regulatory Tier I capital-to-risk-weighted assets	8.6	8.7	8.9	8.6	9.1	9.6	9.9	10.3	9.4
Capital to assets	5.5	5.6	5.2	5.2	5.1	5.0	4.8	3.1	3.0
Nonperforming loans net of provisions to capital 1/	30.0	32.3	31.3	31.1	31.2	24.3	19.2	15.7	12.2
Nonperforming loans to total gross loans 1/	2.7	2.5	2.2	2.3	2.4	2.0	1.5	1.2	0.8
Sectoral distribution of loans to total loans									
Households	46.3	47.2	49.5	50.2	50.2	51.0	49.9	49.3	48.8
Nonfinancial companies	41.6	39.8	37.6	36.3	34.2	31.7	29.6	28.6	29.3
Insurance companies and pension funds	1.2	1.0	1.0	1.3	1.4	1.0	1.7	2.0	2.0
Other financial institutions	10.9	12.1	11.9	12.2	14.1	16.3	18.8	20.2	19.8
Return on assets	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4
Return on equity	11.5	15.6	15.6	15.7	11.8	14.8	16.8	15.4	15.4
Interest margin to gross income (ratio)	58.4	57.8	52.0	56.3	60.1	60.5	58.9	54.1	51.4
Noninterest expenses to gross income (ratio)	77.0	73.3	72.1	77.7	80.2	75.5	70.5	70.1	74.0
Net open position in foreign exchange to capital	59.5	72.1	100.4	89.4	77.0	59.9	79.6	80.6	91.1

Source: Data provided by the authorities.

Table 4. Netherlands: Indicators of External and Financial Vulnerability, 2001-07

(In percent of GDP; unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007
External indicators							
Exports goods and services							
(annual percent change, in U.S. dollars)	-0.7	4.4	17.8	17.0	9.0	12.9	18.6
Imports goods and services							
(annual percent change, in U.S. dollars)	-0.3	4.4	23.6	17.9	9.7	10.5	18.7
Terms of trade goods (annual percent change)	8.1	1.5	0.8	-0.4	-0.1	-1.4	-0.5
Current account balance	2.4	2.5	5.5	7.5	7.2	8.3	6.6
Inward portfolio investment	-33.6	621.8	-1179.9	1964.6	-1162.4	-234.0	-1864.5
Inward foreign direct investment	128.2	1050.5	1129.9	291.9	705.3	110.0	3482.1
Official reserves (in billions of U.S. dollars)	16.9	19.0	21.6	21.2	20.5	23.9	26.9
Foreign assets of the banking sector							
(in billions of U.S. dollars)	211.4	256.2	308.2	376.9	409.0	568.1	741.8
Foreign liabilities of the banking sector							
(in billions of U.S. dollars)	250.1	305.8	328.2	392.5	418.0	562.9	709.0
Official reserves in months of imports	0.8	1.0	1.0	0.9	0.7	0.8	0.8
Exchange rate (per U.S. dollar, period average)	1.12	1.06	0.88	0.80	0.80	0.80	0.73
Financial market indicators							
Public sector debt (Maastricht definition)	50.7	50.5	52.0	52.4	52.4	48.0	46.0
Government bond yield	5.0	4.9	4.1	4.1	3.4	3.8	4.3
Government bond yield (real)	-0.1	1.1	1.9	2.7	1.9	2.1	2.7
Stock market index	506.8	322.7	337.7	348.1	436.8	495.3	515.8
Spread of government bond yield with Germany	0.16	0.11	0.05	0.06	0.02	0.02	0.07
Financial sector risk indicators							
Residential mortgage loans to total loans (in percent)	25.3	25.3	25.2	25.1	28.6	26.0	24.1
Nonperforming loans to total gross loans (in percent) 1/	2.28	2.38	1.99	1.54	1.22	0.75	…
Geographical distribution of credit (percent of total)							
Domestic Economy				40.98	35.16	33.69	30.18
Advanced economies				54.72	59.81	60.45	61.60
Emerging markets and eveloping countries				4.31	5.03	5.86	8.22
:Africa				0.08	0.09	0.13	0.15
of which: Sub- Sahara				0.08	0.09	0.12	0.15
:Central and Eastern Europe				1.06	1.21	1.22	1.88
:Commonwealth of independent states and Mongaolia				0.31	0.36	0.53	0.69
:Developing China, including China				0.91	0.93	1.03	1.61
:Middle-East				0.17	0.25	0.28	0.41
:Latin America				1.78	2.18	2.66	3.47
Contingent and off-balance-sheet accounts							
to total assets (in percent)	20.3	19.5	16.7	15.3	14.6	14.9	…
Risk-based capital-asset ratio	11.7	12.0	12.3	12.3	12.6	11.9	13.2

Sources: Data provided by the authorities; and IMF, *IFS.*

1/ Average of the three largest banks.

Table 5. Netherlands: Structural Measures to Raise Labor Participation and Enhance Productivity—Recent and Planned Actions

Area	Actions Taken	Actions Planned
	In general the government has formed a commission to advise measures to increase labor participation. The proposals of the commission are expected in summer 2008.	
Disability	Latest reform came into effect in January 2006. Reform entails: strengthened eligibility criteria, including a tighter definition of full disability, and work incentives for partially disabled. The government introduced on 2/1/2008 wage subsidies, to foster “bridge-jobs” for partially disabled and former (partially) disabled people whose degree of disability has been reassessed.	The cabinet is preparing changes in the Wajong (law for young disabled) to stimulate labor participation by postponing Wajong eligibility until 27 years of age (while maintaining income support rights).
Unemployment benefits	Effective October 2006, the maximum duration was cut from 60 to 38 months.	Abolishing social assistance for people aged less than 27 years in combination with a study/work obligation. The government intends to change some rules in unemployment insurance in order to stimulate the unemployed to take up jobs not necessarily aligned with their own education level or which pay less than the unemployment benefit. The cabinet is also developing plans to allow the employment agency (UWV) to give wage subsidies for work to the long-term unemployed. (The municipalities can already give wage subsidies for work to people on social security.) Further, the cabinet wants to permit “participation jobs.”
Poverty and inactivity traps	To lessen these traps, changes in the real estate tax and amendments to the child credit (which came into effect in 2006) reduced spikes in marginal effective tax rates.	The new cabinet will introduce an earned income tax credit (EITC) in 2009, but the parameters still have to be determined.
Female participation	To increase female participation, the government increased childcare subsidies by €130 million in 2006 and a further €125 million in 2007. The government introduced legislation requiring primary schools to organize childcare with certified childcare providers from the beginning of the 2007–08 school year if parents so request.	Phasing out, by 6⅔ percent every year, of the imputation of the general tax credit to the primary worker over the period 2009–2024. This will apply only to partners born after 1971 who do not have children aged under six years.

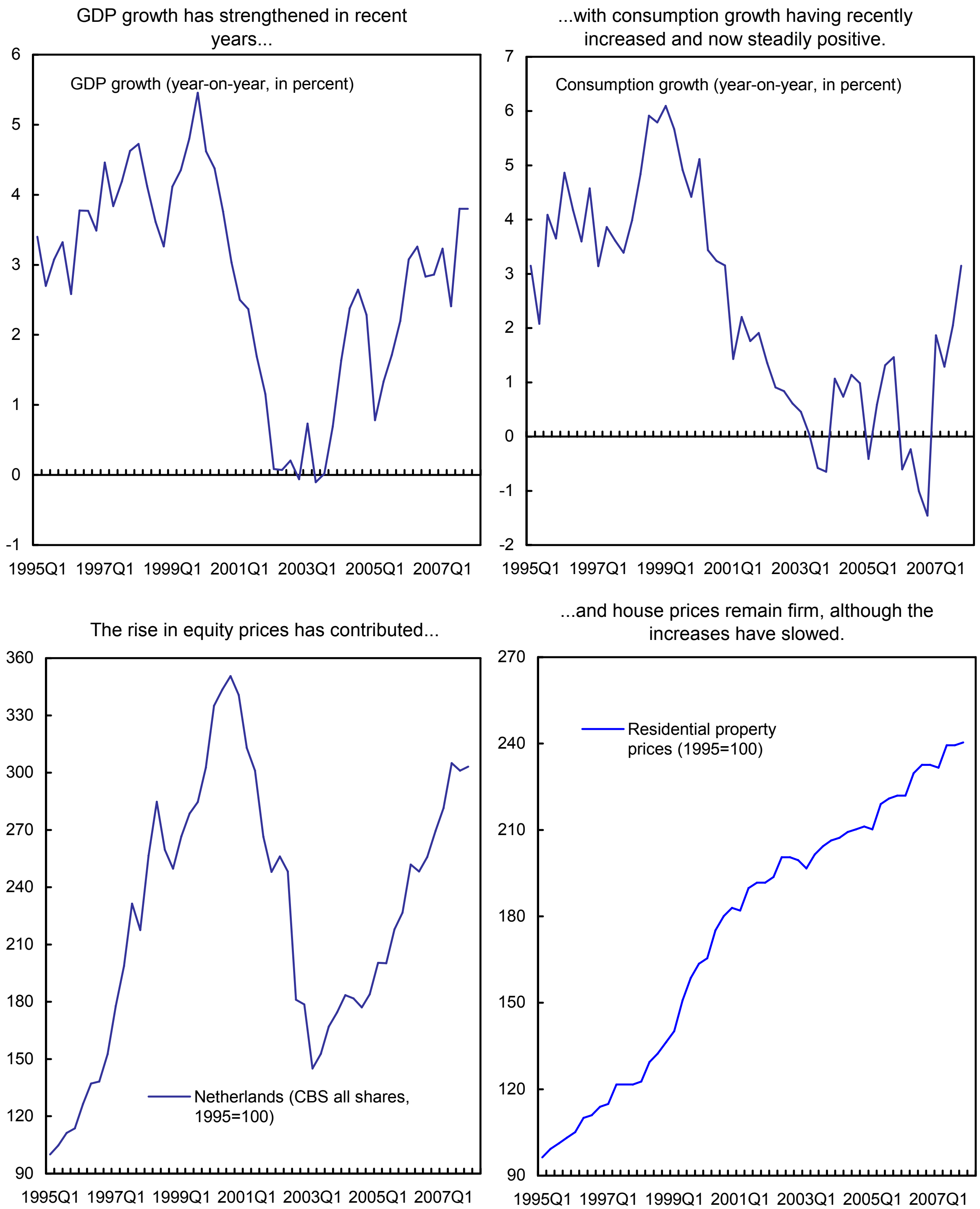
Table 5. Netherlands: Structural Measures to Raise Labor Participation and Enhance Productivity—Recent and Planned Actions (concluded)

Area	Actions Taken	Actions Planned
		At the same time, the level of the general tax credit will be fixed in nominal terms. Starting in 2009, the above measures will boost household revenues by €0.5 billion annually (until 2011). An extra €700 million by 2011 will be made available for child care over the cabinet's term.
Elderly participation	Fiscal incentives for early retirement were removed in January 2006.	Action plan 45+, whereby CWI (the employment office of the Netherlands) will assist 30,000 people aged 45 and older to find a job.
		Plan to Increase work-related tax credits for workers over age 57 and restrict the pensioners' exemption from social contributions only to those retiring at 65, except for certain categories—the latter measure is to be phased over [ten years].
Employment protection legislation (EPL)	Effective October 2006, the LIFO principle for worker dismissal was eased. Effective October 2006, dismissed workers no longer have to prove they resisted being laid off to get unemployment benefits.	
Product Markets	The competition agency (NMa) has become formally independent in July 2006 and its investigative and enforcement powers were enhanced on October 1, 2007.	Further reduction of red tape by 25 percent.
	Significant progress was made towards meeting the previous cabinet's goal of lowering red tape by 25 percent by the end of its term (2007), including by reducing the number of permits and simplifying the license system.	

Table 6. Netherlands: Labor and Product Market Reforms

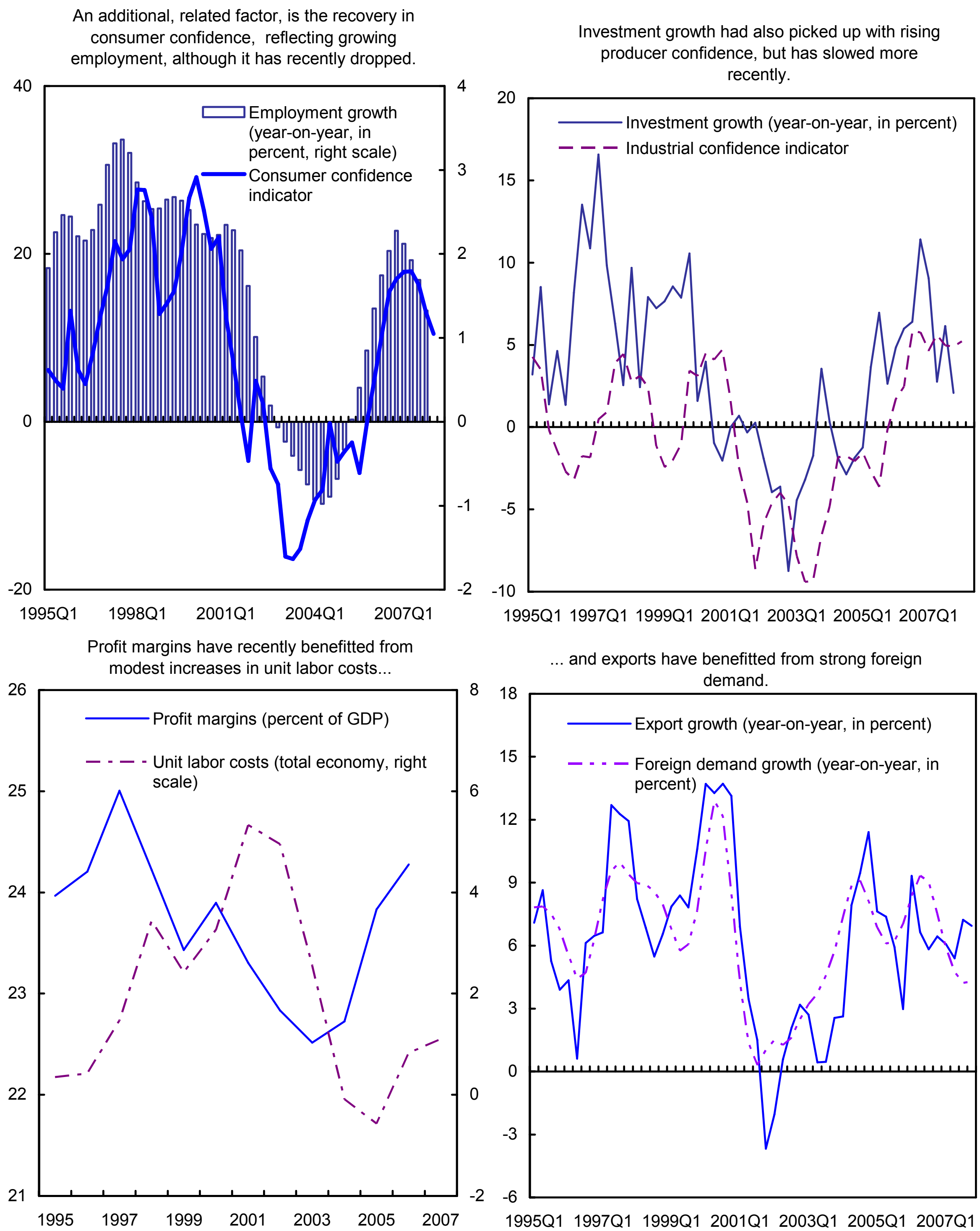
Main Issues	Staff Recommendations	Authorities' Views
Labor Market		
Taxation		
High effective tax rate on second family earners and the imputation of the general tax credit to the primary worker act as a disincentive on second earners' participation. Despite relatively high employment rates, with a short average work week and the majority of women employed part-time (Figure 6), hours worked are the lowest in the OECD.	To induce more female employment, the mission counseled further to reduce the high effective tax rate on second family earners (by phasing out less rapidly social benefits as a function of family income). The mission also recommended faster elimination of the imputation of the general tax credit to the primary worker, presently spread over 15 years from 2009, which would also lower disincentives for second earners.	The authorities remarked that reducing the effective tax rate on second family earners is costly to the budget and could only be introduced slowly. The authorities aired support for faster elimination of the general tax credit to the primary worker, but stressed that the existing schedule reflected a difficult compromise among social partners and changes would be hard.
Unemployment and Disability Benefit		
The share of working-age population receiving social entitlements is comparatively high (almost 17 percent), with those on disability benefit alone totaling nearly 10 percent. In addition, the length of the unemployment benefit is still above comparators.	Staff urged stricter enforcement of requirements for work availability and extension of the new tighter rules for obligatory periodic reassessment of disability status to those over 45 years of age. Regarding unemployment entitlements, the mission argued that the benefit length could be further tightened, or benefits could be diminished over the unemployment spell to intensify job search activity,	The authorities explained that opposition to tougher disability reassessments for older workers was insurmountable at present. On the other hand, steps were under consideration to limit use of the young disabled scheme. The authorities did not dispute staff's view regarding unemployment entitlements, but stressed that these steps require agreement with social partners.
Employment Protection Legislation (EPL)		
EPL on regular contracts is high in international context. Strict EPL for regular employment results in high long-term unemployment, hinders labor mobility and the adoption of innovative processes. In addition, severance payments are comparatively generous, and may also reduce labor mobility to prevent loss of accumulated severance rights.	The mission advocated a degree of EPL liberalization and a funded severance pay scheme designed to promote mobility.	The authorities explained that differences of view among members of the governing coalition had not been resolved and therefore actions in this area during the current legislature were unlikely.
Product Market		
The Netherlands is an outlier in high barriers to entrepreneurship, partly due to cumbersome licensing requirements, and only achieves middling rank in product market regulation. Despite recent improvements, zoning regulations and shop opening hours remain strict.	The mission advocated further reduction of administrative burden and greater regulatory liberalization, including zoning restrictions and shop opening hours.	The authorities argued that their innovation pillar should facilitate the adoption of new technologies. The recent strengthening of the competition authority's (NMa) investigative powers should kindle competition and thus productivity. Finally, the government intends to reduce red tape by an additional 25 percent. The authorities stressed that liberalization had to be gradual.

Figure 1. Netherlands: The Economic Expansion Gained Strength



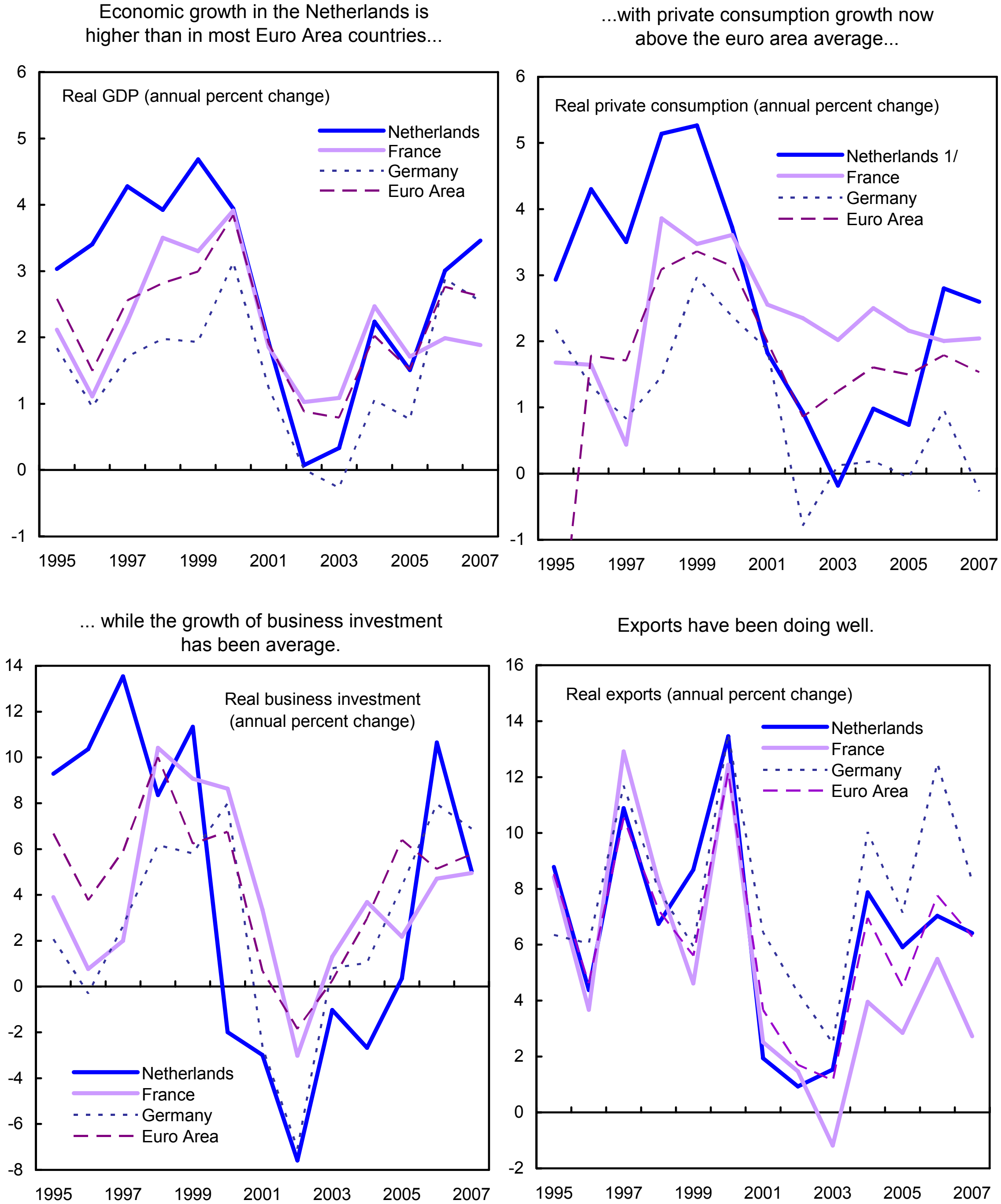
Sources: Global Insight; Netherlands authorities; and IMF, *IFS and WEO*.

Figure 1. Netherlands: The Economic Expansion Gained Strength (concluded)



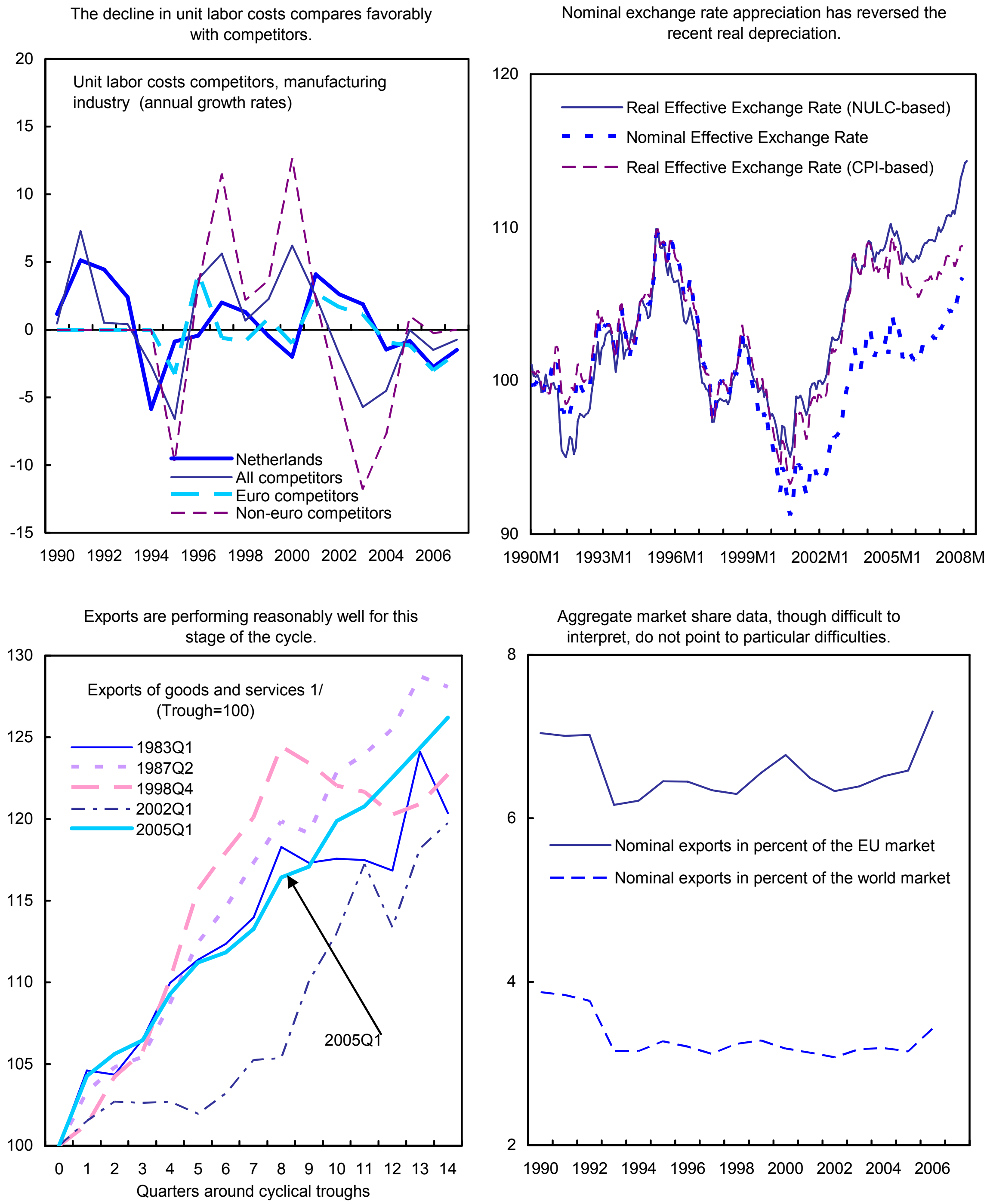
Sources: Global Insight; Netherlands authorities; and IMF, *IFS* and *WEO*.

Figure 2. Netherlands: Comparative Economic Performance Has Recently Been Strong, With Growth That Is Broad Based



Sources: Global Insight; Netherlands authorities; and IMF, *IFS and WEO*.
1/ The consumption growth in 2006 is adjusted for the health care reform. The reform of the health care system at the beginning of 2006 resulted in a shift of health care expenditures of about euro 8.0 billion (1.5 percent of GDP) from private to public consumption, distorting private consumption downward by about 3 percentage points in 2006.

Figure 3. Netherlands: External Competitiveness

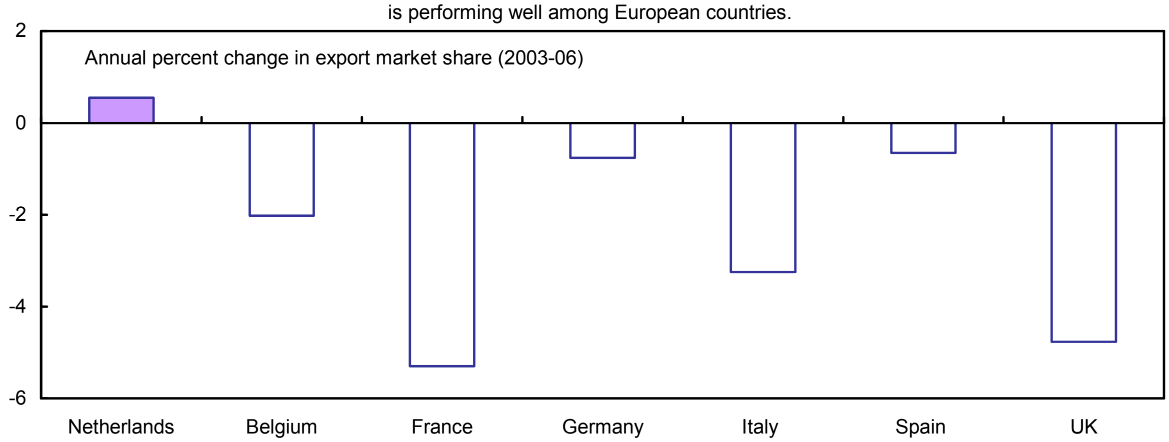


Sources: CPB; OECD, Economic outlook; IMF, *INS*, *DOT*, and *WEO*.

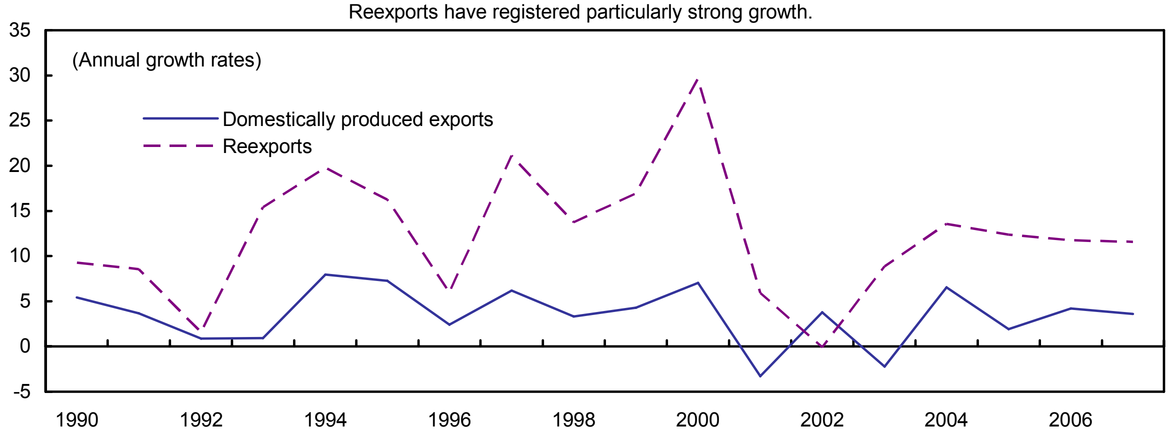
1/ Troughs were identified using the methodology of Harding and Pagan (2002), "Dissecting the Cycle: A Methodological Investigation," Journal of Monetary Economics.

Figure 3. Netherlands: External Competitiveness (concluded)

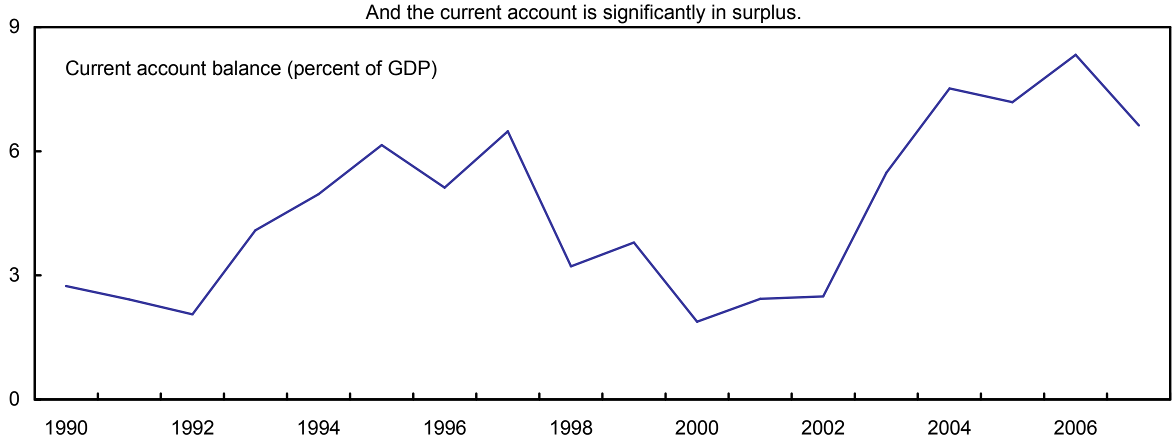
Export market share has tended to decline in many countries, partly reflecting the expansion of exports from many emerging market countries such as China & India. On a comparative basis, the Netherlands is performing well among European countries.



Reexports have registered particularly strong growth.

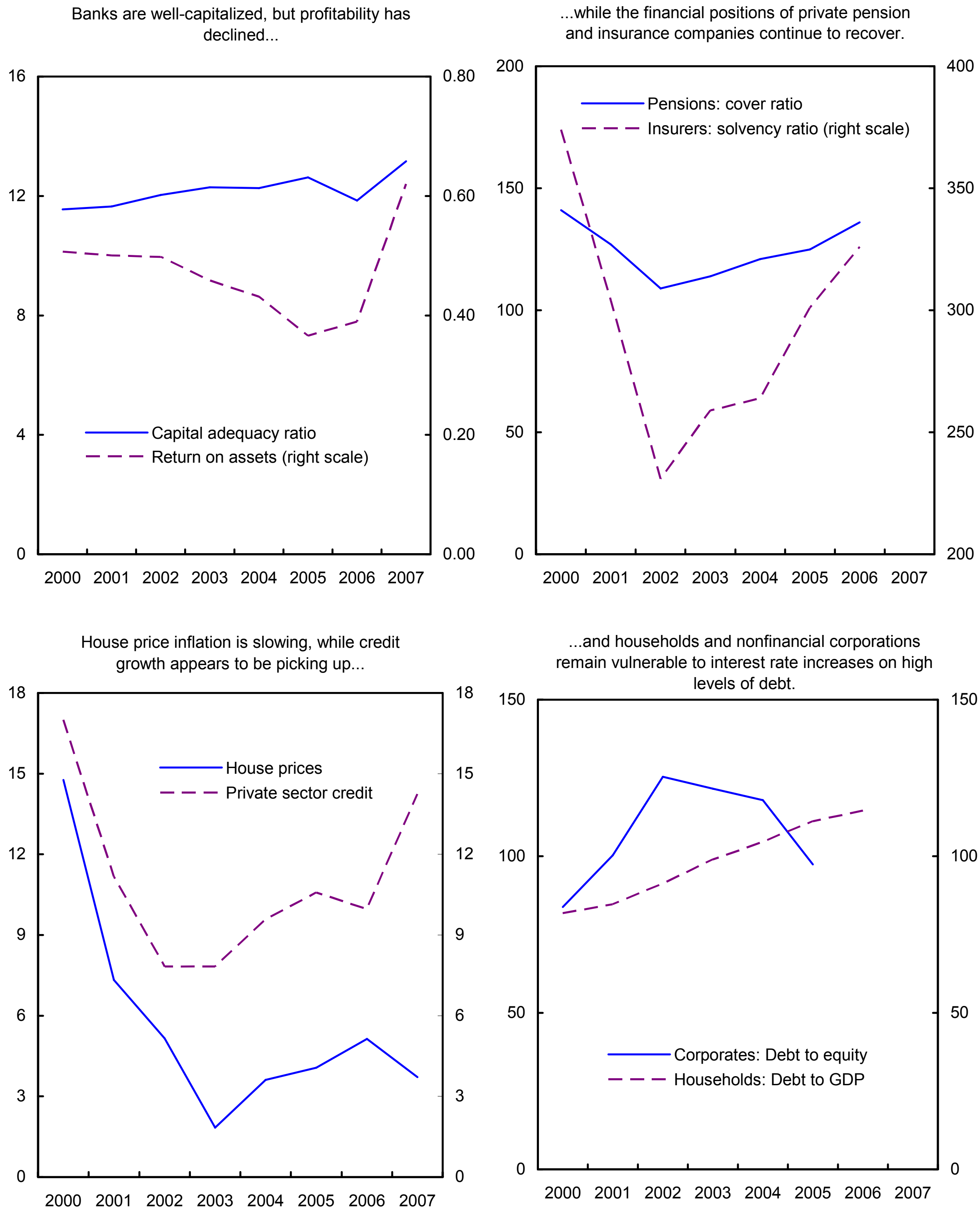


And the current account is significantly in surplus.



Sources CPB; IMF, INS, DOT, and WEO.

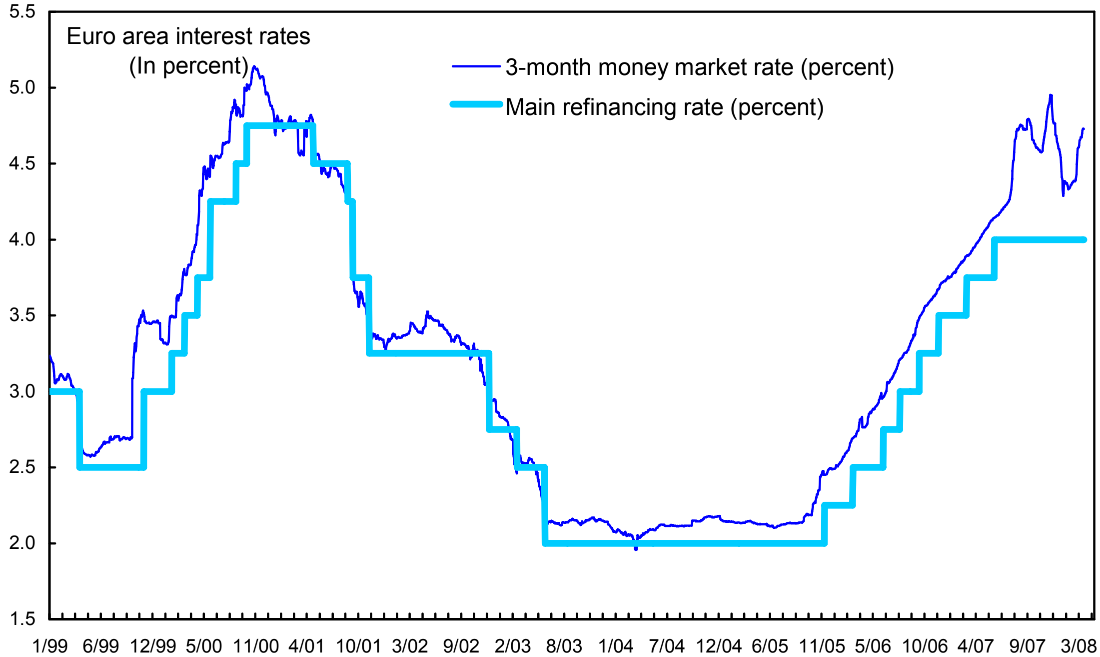
Figure 4. Netherlands: Financial Stability Indicators
(In percent)

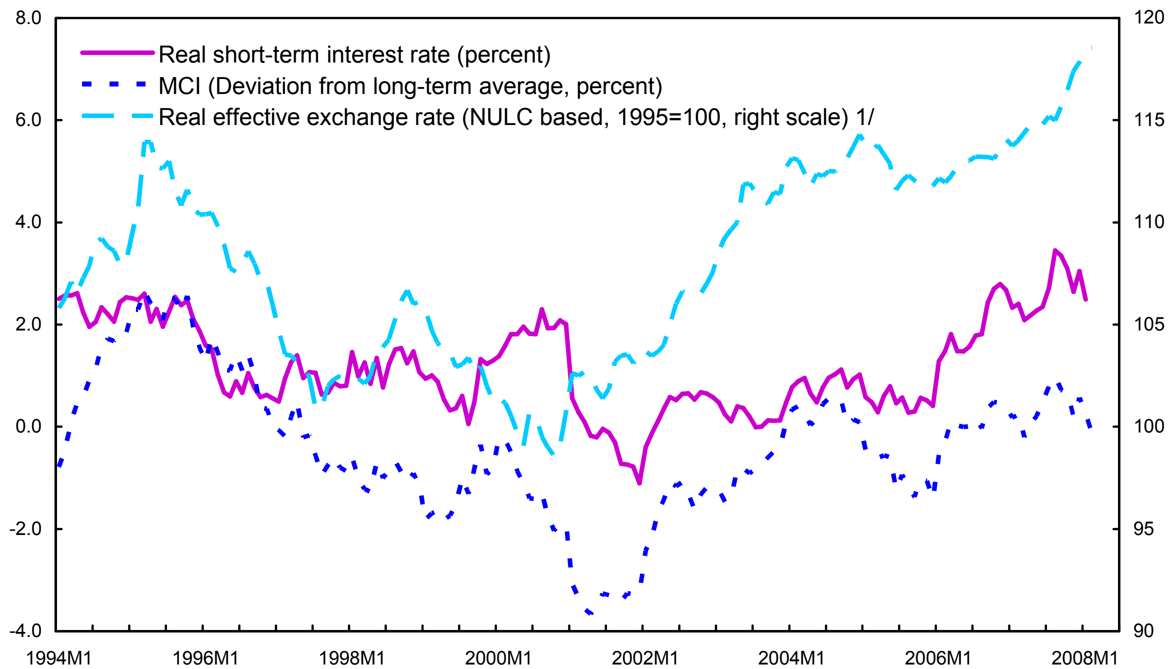


Sources: Global Insight; data provided by the authorities; and IMF, IFS.

Figure 5. Netherlands: Monetary Conditions

Interest rates increased steadily in 2006 and into 2007, while monetary conditions tightened through August and then paused as rising inflation reduced real short-term interest rates.

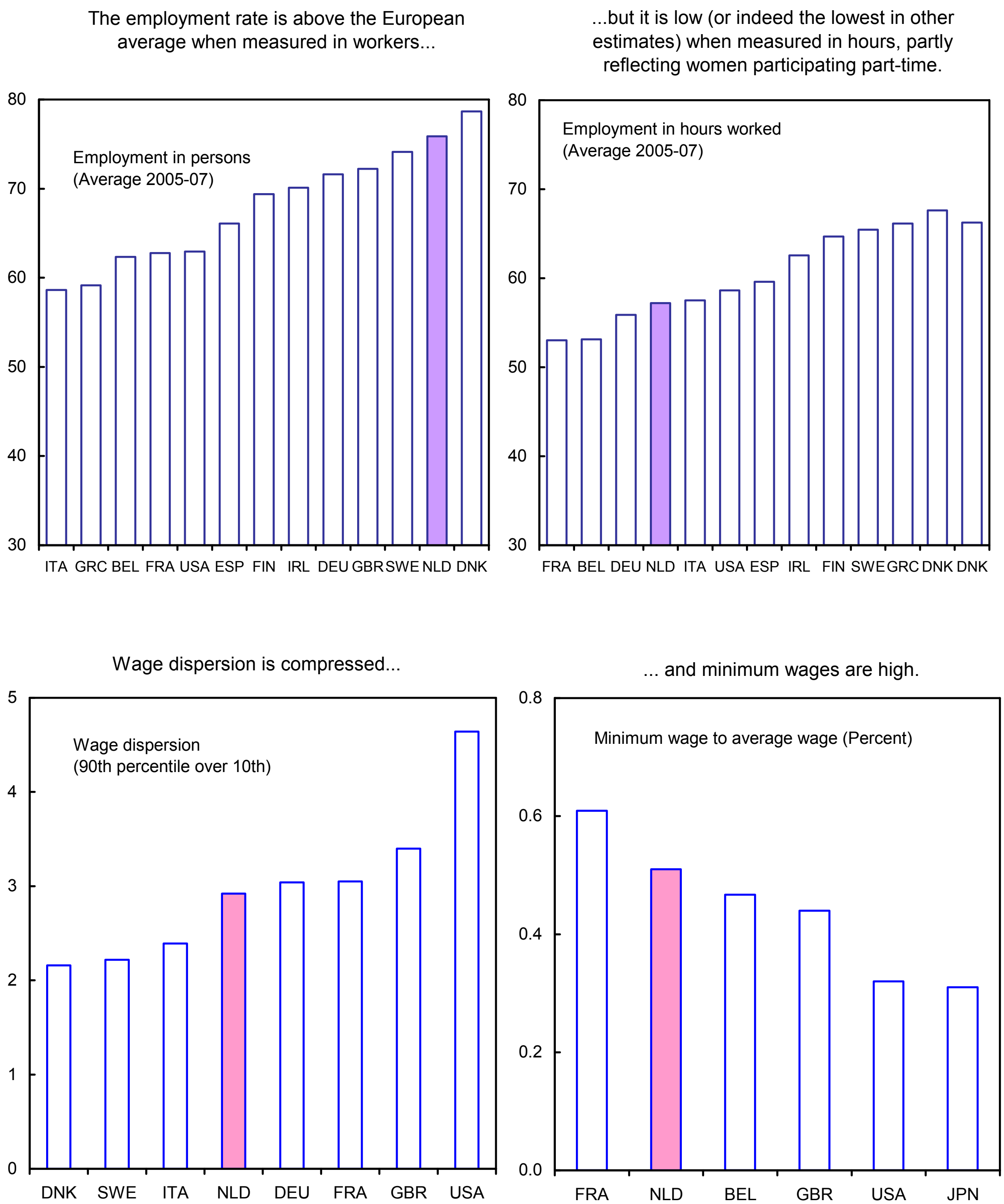




Sources: Global Insight; and IMF, IFS.

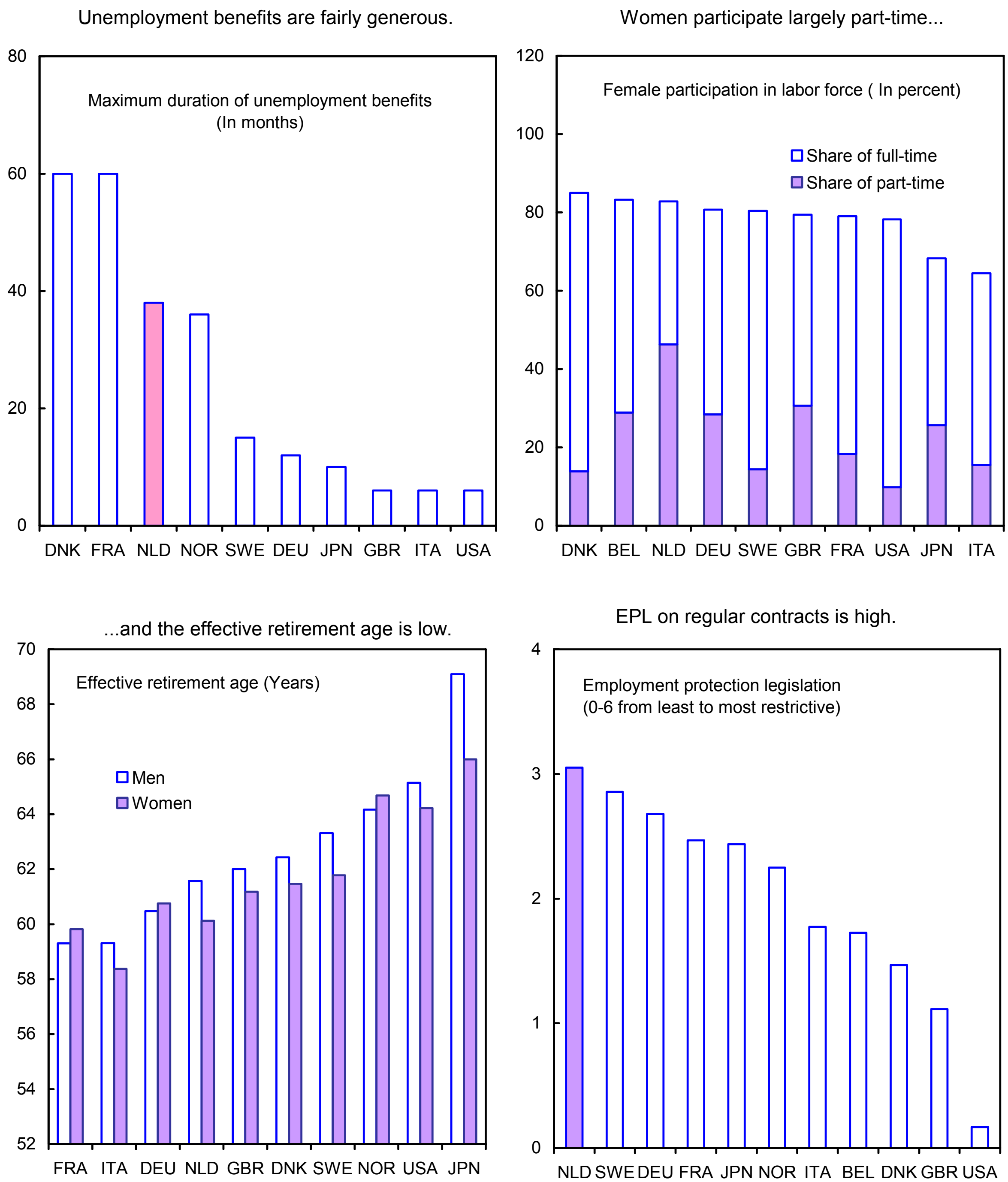
1/ An increase implies less accommodative conditions.

Figure 6. Netherlands: Selected Labor Market Indicators



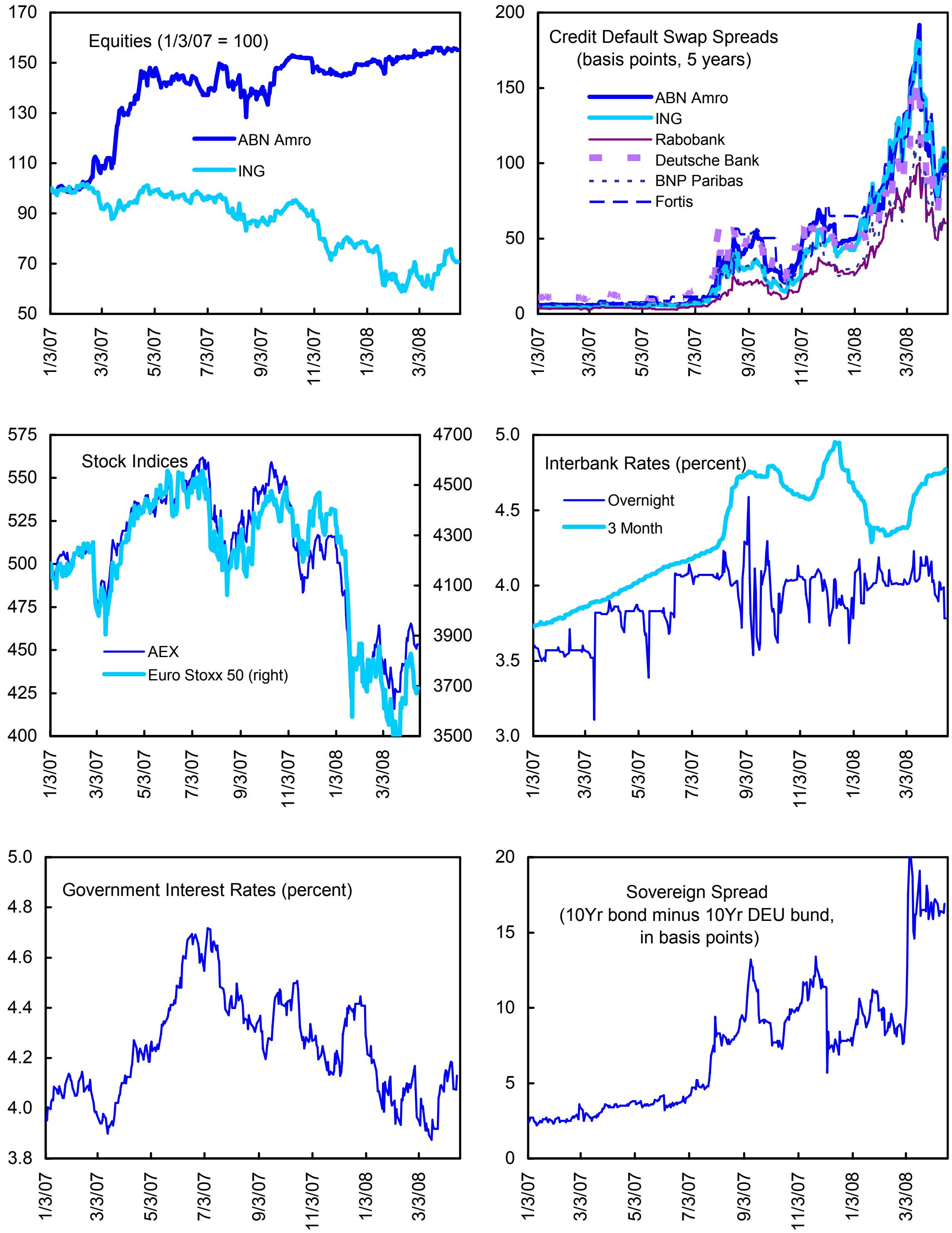
Source: OECD.

Figure 6. Netherlands: Selected Labor Market Indicators (concluded)



Source: OECD.

Figure 7 . Netherlands: Financial Indicators



Sources: Thomson Financial/DataStream and Bloomberg.

Appendix I. Netherlands: Fund Relations

(As of March 31, 2008)

I. **Membership Status:** Joined December 27, 1945; Article VIII.

II. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	5,162.40	100.00
Fund holdings of currency	4,833.08	93.62
Reserve position in Fund	329.36	6.38

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	530.34	100.00
Holdings	553.76	104.42

IV. **Outstanding Purchases and Loans:** None

V. **Latest Financial Arrangements:** None

VI. **Projected Obligations to Fund** (SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2008	**2009**	**2010**	**2011**	**2012**
Principal					
Charges/interest	0.03	0.03	0.03	0.03	0.03
Total	0.03	0.03	0.03	0.03	0.03

VII. **Exchange Rate Arrangements:**

The Netherlands' currency is the euro, which floats freely and independently against other currencies.

VIII. **Article IV Consultation:**

Discussions for the 2008 Article IV consultation were held in Amsterdam and The Hague from March 6–17, 2008. The staff report for the 2007 Article IV Consultation (IMF Country Report No. 07/216, 6/22/07) was considered by the Executive Board on June 13, 2007. The Article IV discussions with the Netherlands are on the standard 12-month consultation cycle.

IX. **Exchange Restrictions:**

The Netherlands maintains an exchange system free of restrictions on payments and transfers for current international transactions, except for restrictions maintained solely for security reasons. These measures are established by European Union regulations and have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Appendix II. Netherlands: Staff Analytical Work, 2000–07

Fiscal Policy

- *Volatility of Tax Revenues in the Netherlands,* IMF Country Report No. 06/284.
- *Budgetary Policymaking in the Netherlands*, IMF Country Report No. 05/225.
- *Recent Fiscal Developments in the Netherlands*, IMF Country Report No. 04/301.
- *Medium-Term Fiscal Policy,* IMF Country Report No. 02/123.
- *Health Care Reform*, IMF Country Report No. 02/123.

The Financial Sector

- *House Prices in the Netherlands: Determinants, Concerns, and Considerations Related to Phasing Out the Tax Deductibility of Mortgage Interest Payments,* IMF Country Report No. 06/284.
- *The Financial Sector in the Netherlands: A Health Check and Progress Report on the FSSA Recommendations,* IMF Country Report No. 05/225.
- *House Prices in the Netherlands,* IMF Country Report No. 05/225.
- *Second Pillar Pensions, Stock Market Returns, and Labor Demand,* IMF Country Report No. 03/240.

Labor Markets

- *Wage Bargaining in the Netherlands,* IMF Country Report No. 03/240.
- *Inactivity and Poverty Traps,* IMF Country Report No. 02/123.
- *Reform of the Disability Program,* IMF Country Report No. 02/123.
- *The Labor Income Tax Credit in an International Perspective,* IMF Country Report No. 01/96.

Growth, Productivity, and Related Cyclical Issues

- *Potential Growth and Total Factor Productivity in the Netherlands,* IMF Country Report No. 06/284.
- *The External Competitiveness of the Dutch Economy: A Short Note on Evidence from both Aggregate and Disaggregate Data,* IMF Country Report No. 05/225.
- *Long-Run Household Consumption Equilibrium in the Netherlands,* IMF Country Report No. 05/225.
- *Recent Productivity Trends in the Netherlands,* IMF Country Report No. 04/301.
- *Estimating Potential Growth and Output Gaps for the Netherlands,* IMF Country Report No. 03/240.
- *Dealing with Cyclical Tensions,* IMF Country Report No. 00/88.

Appendix III. Netherlands: Past Fund Policy Recommendations and Implementation

Past Staff Recommendations	Implementation
Fiscal Policy: Past recommendations included structural fiscal adjustment of at least ½ percentage point of GDP per year, closer coordination between the central government and the local governments, refinements to enhance the transparency of the fiscal framework (e.g., reporting of tax expenditures in the budget and their inclusion in the expenditures ceiling), and to reduce a few procyclical features.	Fiscal consolidation of over 2½ percentage points of GDP, in structural terms, was achieved during 2003–07. The authorities improved coordination between various levels of government, recently excluded interest payments from the expenditures ceiling, lowered the "signaling value,"[1] introduced fixed funding of the FES.
Labor Market: Past recommendations included tightening unemployment benefits, abolishing fiscal incentives for early retirement, reducing inactivity traps, reassessing disability entitlements, and liberalizing employment protection legislation.	Maximum duration of unemployment benefits was lowered to 38 months—which however remains high in international comparison. Tax/benefit incentives for early retirement were eliminated, "poverty traps" attenuated, and disability rights tightened. Recommendations not yet taken on board include: (i) reducing the still high effective tax rate on second family workers, in part through faster elimination of the imputation of the general tax credit to the primary worker; (ii) tightening access to the disability scheme by the young; (iii) stricter enforcement of work availability requirements for the partially disabled and unemployed; (iv) extension of the new more severe rules for periodic reassessment of disability status to those aged 45 and over; and (v) raising the retirement age or linking it to life expectancy. In addition, as noted, unemployment benefit maximum length is still quite generous.
Product Market: The Fund has generally supported the authorities' own liberalization program, including the regional unbundling of the energy market, the reduction in required licenses and permits, and, more generally, the efforts to increase competition and reduce the cost of doing business.	The powers of the competition authority have been gradually increased. The previous government achieved its goal of a 25 percent reduction in administrative burden and the new government manifested its intention to lessen it by an additional 25 percent. However, barriers to entrepreneurship and product market regulation are still relatively high. For example, despite recent progress, licensing requirements remain burdensome, zoning regulations stringent, and shop opening/delivery hours strict.
Financial Sector: the key recommendations from the 2004 Financial Sector Stability Assessment (FSSA) included passage of a new Financial Supervision Act, clarifying the framework for financial sector supervision and the authority of the minister, improvements in security settlement systems, introduction of the new regulatory framework for pension funds, establishment of a Financial Stability Division, expanding stress testing models, strengthening the AML-CFT framework, eliminating or at least reducing mortgage interest deductibility, and introducing a mortgage code of conduct.	The authorities have implemented most of these recommendations. There is only partial progress regarding mortgage interest deductibility, which has not been phased out but the authorities have made small reductions. Similarly, the mortgage code of conduct has been strengthened, but it has not been very effective in reducing the high LTV ratio. The approach to stress testing could be further extended.

[1] The "signaling value" is the fiscal balance ratio to GDP below which corrective measures must be taken to avoid breaching the Maastricht criteria. It has been reduced to 2 percent from 2½ percent of GDP.

Appendix IV. Netherlands: Statistical Issues

April 10, 2008

The Netherlands publishes a wide range of economic and financial statistics. Specifically, annual and quarterly national account data are provided by the Central Bureau of Statistics; financial and balance of payments data are provided by De Nederlandsche Bank; and fiscal data are provided by the Ministry of Finance. These data are increasingly available in electronic form. Macroeconomic data are generally of high quality.

As a one-off matter, a number of institutional reforms had a significant impact on national account and other data in 2006. Most importantly, the reform of health care insurance caused a significant reclassification of private consumption into public consumption. This shift had a big impact on the growth rates of the components concerned, but overall GDP was not affected.

The frequency and timeliness of the availability of the statistical indicators required for Fund surveillance purposes are summarized in the attached table. The authorities subscribe to the Special Data Dissemination Standard, providing information about their data and data dissemination practices on the IMF Dissemination Standards Bulletin Board. In addition, they have committed to a ROSC data module mission tentatively set for later this year.

Netherlands: Table of Common Indicators Required for Surveillance
(as of April 10, 2008)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	Current	Current	Daily and Monthly	Daily and Monthly	Daily and Monthly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	02/08	3/18/08	Monthly	Monthly	Monthly
Reserve/Base Money[2]	02/07	04/07	Monthly	Monthly	Monthly
Broad Money[2]	02/07	04/07	Monthly	Monthly	Weekly and Monthly
Central Bank Balance Sheet	02/08	4/7/08	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	02/08	4/7/08	Monthly	Monthly	Monthly
Interest Rates[3]	Current	Current	Daily and Monthly	Daily and Monthly	Daily and Monthly
Consumer Price Index	03/08	4/17/08	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[4,5]—General Government[6]	Q4 2005	Jun.05	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing[4,5]—Central Government	03/07	7/10/07	Monthly	Monthly	Monthly
Stocks of Central Government and Central Government-Guaranteed Debt[7]	Q1 2007	Apr. 07	Quarterly	Quarterly	Quarterly
External Current Account Balance	Q3 2007	1/22/08	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q3 2007	1/22/08	Quarterly	Quarterly	Quarterly
GDP/GNP	Q4 2007	4/7/08	Quarterly	Quarterly	Quarterly
Gross External Debt	Q4 2006	Apr. 07	Quarterly	Quarterly	Quarterly

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Pertains to contribution to EMU aggregate.
[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] While data on total revenues and expenditures and the fiscal balance of the general and central governments are available on a monthly basis, detailed breakdowns are not available on that high frequency.
[6] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[7] Including currency and maturity composition.

Statement by the IMF Staff Representative
May 21, 2008

1. **This statement summarizes developments in the Netherlands since the issuance of the staff report**. The additional information does not change the thrust of the staff appraisal.

2. **Economic growth slowed in the first quarter of 2008, while inflation remains significantly below the euro area average.**

- Real GDP rose by 0.2 percent in the first quarter of 2008, the lowest quarter-on-quarter rate for three years. This is below the preliminary estimate of 0.7 percent quarterly growth in the euro area. However, expansion from the same quarter of last year—at 3.1 percent—continues to exceed the euro area average (2.2 percent), because of strong growth in the latter part of 2007. The slowdown reflects a deceleration of consumption, especially in consumer durables, and exports. In contrast, business investment stayed strong.

- Harmonized inflation dipped to 1.7 percent (12-month change) in April from a recent peak of 2.0 percent in February. It remains well below the 3.3 percent euro area rate, the result of comparatively smaller price increases for food, rent, and energy in the Netherlands.

These developments in GDP growth and inflation are both broadly consistent with the projections in the staff report.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 08/64
FOR IMMEDIATE RELEASE
June 3, 2008

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2008 Article IV Consultation with the Kingdom of the Netherlands—Netherlands

On May 21, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands—Netherlands.[1]

Background

Strong macroeconomic foundations have so far largely shielded the Netherlands from recent financial turbulence. Growth in recent years has been above and inflation below euro area averages. Economic expansion is expected to slow this year to 2-2¼ percent, which, in light of a large carryover from 2007, reflects a substantive deceleration owing to the global turmoil and spillover from the U.S. downturn. Inflation should remain subdued, slightly above 2 percent, although with a tightening labor market, wage increases are anticipated to accelerate somewhat and to exceed productivity growth. Uncertainties surrounding the outlook are high, mainly owing to uncertainties on the extent of the global financial distress and its impact on consumer and producer confidence, but the risks are broadly balanced.

The external current account surplus remains large and various approaches support the conclusion that Dutch competitiveness is satisfactory. Thus, standard real effective exchange rates have been relatively stable in recent years, while application of the Consultative Group on Exchange Rates (CGER) methodology suggests that the real exchange rate is broadly in

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

equilibrium. Rapid export growth also implies that external competitiveness is not at stake, although sectoral analyses capture some early signs of erosion.

Fiscal performance, while staying strong, was mildly procyclical in 2007. Although the overall surplus was unchanged at ½ percent of GDP, with output above potential, the structural balance slipped by about ½ percent of GDP. Despite a declining government debt ratio and a strong, fully-funded pillar of the pension system, population aging is anticipated to increase government expenditure by some 7 percentage points of GDP in the coming decades and, without fiscal retrenchment or growth-enhancing structural reforms, render the public accounts unsustainable.

The financial system is proving generally resilient to the recent market turmoil, but some pockets of weakness warrant caution. Stress tests suggest that banks can withstand quite strong shocks, in particular those associated with the ongoing financial turbulence. Risk-weighted capital ratios are comfortable, although the return on assets remains low. While mortgage lending has slowed, the outstanding stock remains among the highest in relation to GDP in mature markets, owing to policy-induced distortions—especially the tax deductibility of mortgage interest payments—and exposes households to interest rate and housing price risks. The takeover of a large bank by an international consortium typifies rising challenges for cross-country supervision.

Executive Board Assessment

Executive Directors noted that sizeable fiscal consolidation and stability-oriented macroeconomic policies, complemented by broad-based structural reforms, have underpinned an extended period of strong growth, outperforming the EU average, and have shielded the economy from the recent global financial turmoil. Directors considered that, despite an expected deceleration in growth following the U.S. economic slowdown, near-term prospects remain favorable, with real GDP expected to continue expanding above the EU average. They acknowledged, however, that the outlook is subject to greater-than-usual uncertainty.

Directors noted that imminent population aging—which will shrink working age population starting early in the next decade—and comparatively low productivity growth could pose considerable challenges to long-term fiscal sustainability and external competitiveness. It will therefore be important to make early progress on labor and product market reforms aimed at raising the employment rate and stimulating faster productivity gains.

Given the expected above-potential output and tight labor market, most Directors agreed that a somewhat tighter fiscal stance for 2008 and 2009 would be appropriate from both long-term sustainability and cyclical perspectives, while acknowledging that the scope for reducing current expenditures might be limited at the present juncture of an economic downturn. Should growth turn out to be markedly lower than projected, automatic stabilizers should be allowed to operate fully. Directors welcomed the commitment of the government to a medium-term structural surplus target of 1 percent of GDP, although most saw scope for a further gradual improvement in the structural primary balance (net of gas proceeds), noting that frontloading the fiscal adjustment would limit the size of the needed fiscal correction and distribute the burden more equitably across generations.

Directors concurred that fiscal adjustment should rely on spending restraint and a broadening of the tax base, given relatively large tax wedges on labor income. Possible sources of savings include efforts to control health care spending, improvements in public sector efficiency, an increase in the effective retirement age, and a reduction in unemployment benefits. Directors also called for increased transparency of tax expenditures to strengthen budgetary discipline.

Directors welcomed the ongoing efforts and the recent announcement of new measures to ease growing labor shortages and the impact of population aging. In this regard, reforms of the tax system and social entitlements should aim to reduce the effective marginal tax rates on second family earners, target tax incentives to induce participation by the elderly, and tighten the enforcement of work availability requirements and reassessments of disability status. Directors encouraged the authorities to further liberalize the rigid employment protection legislation and to adopt other measures with a view to further enhancing labor mobility.

Directors welcomed the authorities' "innovation pillar" and additional efforts to reduce red tape to promote productivity growth. Noting that barriers to entrepreneurship and product market regulation remain relatively high, Directors recommended careful liberalization to facilitate the emergence of innovative firms, which can make greater use of productivity-enhancing information technologies.

Directors observed that the Dutch financial system is healthy and well poised to weather the global turmoil, and they strongly welcomed the enhanced supervisory and regulatory framework. In view of growing risks associated with cross-border financial integration and increased use of structured products, Directors underscored the importance of strengthening cooperation and information-sharing among supervisors in home and host countries, as well as transparency in reporting complex products, while increasing cost efficiency and equity capital.

Directors noted the staff's assessment that overvaluation of the Dutch housing market is only minor, while stressing that high household mortgage indebtedness, and house price developments in general, warrant careful monitoring. They saw benefit in regulatory action to reduce high loan-to-value ratios, improve the measurement of related collateral, and fine-tune capital requirements for loans with different risks. Gradual removal of mortgage interest deductibility would contribute to decrease loan-to-value ratios, thereby lowering households' vulnerability to house price swings and interest rate shocks.

Directors commended the authorities' continued commitment to high levels of Official Development Assistance.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2008 Article IV Consultation with the Kingdom of the Netherlands -- Netherlands is also available.

Netherlands: Selected Economic Indicators

	2004	2005	2006	2007	2008 1/	2009 1/
Real economy (change in percent)						
Real GDP	2.2	1.5	3.0	3.5	2.1	1.6
Domestic demand	0.6	0.9	3.4	2.6	2.3	1.2
CPI (harmonized)	1.4	1.5	1.7	1.6	2.4	1.8
Unemployment rate (in percent)	4.9	5.0	4.1	3.4	3.0	3.0
Gross national saving (percent of GDP)	26.5	26.2	28.1	26.7	25.8	25.1
Gross domestic investment (percent of GDP)	19.0	19.1	19.7	20.1	19.9	19.5
Public finance (percent of GDP)						
General government balance	-1.9	-0.2	0.6	0.6	1.1	1.4
Structural balance	-1.2	-0.2	1.0	0.4	0.7	1.3
General government debt	52.4	52.4	48.0	46.0	43.6	40.7
Interest rates (percent)						
Money market rate 2/	2.1	2.2	3.1	4.3	4.5	...
Government bond yield 2/	4.1	3.4	3.8	4.3	4.1	...
Balance of payments (in percent of GDP, unless otherwise indicated) 3/						
Trade balance	6.7	7.1	6.7	6.6	6.2	5.7
Current account	7.5	7.2	8.3	6.6	5.9	5.6
Exports of goods and services	64.2	67.6	70.8	73.7	76.5	79.4
Volume, growth (in percent)	8.0	6.1	7.3	7.0	6.5	6.3
Imports of goods and services	56.7	59.2	62.8	65.5	68.5	71.8
Volume, growth (in percent)	6.2	5.2	9.0	7.1	7.4	7.6
Net oil exports (billions of US$)	-1.6	-1.8	-0.9	0.6	0.0	1.6
Net foreign direct investment	-4.0	-13.9	-5.8	-4.8	-3.7	-3.6
Official reserves, excl. gold (US$ billion) 2/	10.7	9.0	10.8	10.7	10.6	...
Reserve cover (months of imports of GNFS)	0.4	0.3	0.3	0.2	...	...
Exchange rate						
Exchange rate regime	Member of EMU					
U.S. dollar per euro	1.34	1.19	1.32	1.46	1.47	1.48
Nominal effective rate (2000=100) 2/	107.6	107.7	108.2	110.2	113.1	...
Real effective rate (2000=100) 2/ 4/	112.6	112.3	112.6	115.3	119.4	...

Sources: International Financial Statistics; OECD; Eurostat; information provided by the Dutch authorities; and IMF staff estimates.
1/ Staff projections.
2/ As of January for 2008.
3/ Transactions basis.
4/ Based on relative normalized unit labor costs.

Statement by Age Bakker, Executive Director for the Kingdom of the Netherlands—Netherlands May 21, 2008

I thank staff for their comprehensive appraisal of the Dutch economy and want to convey the appreciation of the authorities for the informative exchange of views during the mission.

As the Netherlands is among the bigger financial centers in the world, and in line with the direction the Fund should take, my statement will pay relatively much attention to the financial markets.

General comments

- For the past years, the Dutch economy has performed well as reflected by satisfactory economic growth, low inflation and unemployment, and strong fiscal performance. However, after the Dutch economy attained its highest growth rate in seven years in 2007, it is clear that the broad based expansion will slow down this year.

- Whereas the IMF forecasts a relatively sharp slow down, the independent Netherlands Bureau for Economic Policy Analysis (CPB), the European Commission, and other institutions have a somewhat less pessimistic view. Also, given the 1.9 percentage point growth carry-over from 2007 and taking into account first quarter data, IMF's growth forecast of 2.1 for 2008 seems cautious.

- The WEO 2008 included a housing market analysis, which attracted wide attention from the Dutch press, financial markets and policymakers by suggesting a sizable overvaluation of the housing market in the Netherlands. The staff report rightly puts the WEO cross-country study in perspective by noting that Dutch-specific studies, including by the IMF, suggest a small or no house price gap.

Fiscal Policy

The budgetary framework of the Netherlands was found to meet or set international best practices by the 2006 fiscal ROSC. To achieve further improvement, the government implemented several of the Fund's recommendations when taking office last year. The recommendations made during the current consultation will be assessed by the Study Group on the Budget Margin which designs the budgetary policy for the next government. They cannot be taken up earlier since the strong medium-term fiscal framework of the Netherlands prevents the government from changing the rules of the game during its term.

Given pension assets which amount to 176% of GDP (December 2007), the Netherlands is relatively well placed to cope with the budgetary cost of ageing. Nevertheless, the government is committed to further improve the long-term sustainability of public finances. Previous governments have already achieved a reduction of the debt ratio from close to 80%

in the mid-nineties to below 50% of GDP in 2007. The new government is committed to build on this achievement and has defined its budgetary policy agenda in light of an ageing population. Continued budgetary surpluses are expected to bring the debt ratio below 40% in 2009.

The authorities have set a target of a structural surplus of 1% of GDP in 2011, as previously recommended by staff. Recently, the short-term budgetary outlook improved, driven by higher gas revenues. When the Board last discussed the Netherlands in June 2007, staff forecasted a deficit of 0.7% of GDP for 2007; current expectations are that a surplus of 0.4% of GDP has been achieved. Moreover, the structural balance for 2007 is expected to come out half a percentage point better than expected last June. For 2008, a small further improvement in the government balance is expected, again both in nominal and structural terms.

Structural reforms

The commitment to fiscal discipline, as illustrated by aforementioned facts, is being complemented by a structural reform agenda, which work hand-in-hand to address the economic impact of an ageing population. As staff notes, bold reforms have been implemented in the past few years. The effects of these reforms are now starting to pay off. For instance, the staff reports gives disability figures up to 2004, while according to the CPB the volume of disability recipients has dropped by about 10% in 2006 and is expected to drop by a further 20% in the period till 2011. Notwithstanding these positive results, staff rightly notes that further progress needs to be made if the employment and the number of hours worked per employee is to be increased. To this effect, the government has announced new measures.

- The budget for childcare facilities has been increased with an aim to increase female participation. Primary schools are now obligated to arrange pre and after school childcare.
- Changes in the law for young disabled are planned and social assistance for people under 27 will be abolished (income support will be given if needed for education).
- Wage-subsidies for so-called ‘participation jobs’ aimed at gaining work experience have been introduced.
- On top of the various fiscal measures mentioned in the staff report, the tax credit for secondary earners will be changed to reduce the effective marginal tax rate.
- A commission has been established to analyze further reforms to invigorate the labor market; its report will be published in the beginning of June.

Financial Sector

Important structural reforms did also take place in the financial sector. At the instigation of my predecessor here at the Fund, a new financial sector supervision model was introduced in the Netherlands in 2004. According to this ‘twin peaks model’ the systemic and prudential supervision has been concentrated in-house with the central bank (DNB), for the banking, insurance and securities sector, while all conduct-of-business supervision is done by Netherlands Authority for the Financial Markets (AFM). Experience with this model, which currently receives much international attention, has been satisfactory. The authorities are pleased with staff's appraisal that the Dutch financial system appears robust due to a strong capital base and good supervision.

The supervisory model facilitated an appropriate response to the financial market turmoil. When the market turbulence began to emerge, DNB reacted by further intensifying banks´ liquidity monitoring. This included the collation of information derived from banking supervision, the payment system and the financial markets. The combination of central bank and supervisory duties and powers in one institution offered clear advantages in this regard. Also, DNB's bank liquidity supervision required that constructs such as conduits were consolidated in liquidity testing and reporting, and stress tests confirmed the robustness of bank safety margins, even under relatively extreme scenarios. So far, Dutch banks have shown resilience in the face of the financial market turmoil with financial stability indicators and rating agencies' assessment supporting this positive view.

Up until the first quarter of 2008, bank lending to households and firms in the Netherlands has not been materially affected by the turmoil. Lending to households continued its gradual downward path since the beginning of 2006, in line with a moderation of growth of house prices, whereas lending to firms is increasing strongly. That said, the recent Bank Lending Survey provides indications for a tightening of lending conditions, which finds support in indicators of the funding structure, returns and capital ratios of banks. The divergence between the actual growth of bank lending and the indicated tightening of credit standards could be evidence of a time lag in changing lending practices, or to the high persistence of lending growth and favorable domestic economic conditions in the second half of 2007.

Staff raises the issue of the large and increasing loan-to-value (LTV) ratio on new mortgages. In order to prevent payment problems, a renewed Mortgage Lenders' Code of Conduct (the Code) has come into force in 2007 and the AFM has recently announced to tighten its supervision on excessive mortgage lending with particular attention to compliance with the Code. The LTV-ratio has stabilized since the beginning of 2006 and is accompanied by the build-up of assets in insurance and savings accounts. Also, the associated credit risks are contained when measured against available Tier 1 capital and taking into account the low share of vulnerable households with mortgage debt. The impact of interest rate shocks on debt service costs is limited due to the high percentage of long-term fixed rate mortgages.

Staff points to the relative low profitability of the banking sector, which would limit 'its ability to support growth and adaptation of the economy'. However, as staff points out, this lower profitability can be explained by the fact that Dutch banks take on less risks compared to international peers, which is reflected in lower returns. Another reason, not mentioned in the report, is the intensified competition partly due to cross-border financial integration. This may actually imply that Dutch banks are indeed supporting growth and adapting to a changing economic environment.

The takeover of ABN AMRO by a consortium of international banks is exemplary for the increased cross-country integration in the financial sector. The authorities agree with staff that this takeover poses various managerial and supervisory challenges and in this regard there is close cooperation with the UK, Spanish and Belgian authorities. As regards Fortis, which will take over the Dutch retail banking operations of ABN AMRO, joint risk assessments take place with the Belgian authorities as well as frequent cooperation and information sharing on the basis of MOUs, which will be updated as needed. With respect to crisis management, there is a bilateral MOU with the Belgium authorities, while an EU-wide MOU on financial stability will be published soon.

Conclusion

A relatively benign economic environment over the past years has been utilized to strengthen the fiscal position and to introduce a wide range of structural reforms. The financial sector is sound and has weathered the financial turmoil well. Unemployment is low and inflation has so far been contained. That said, the authorities are aware that there is no room for complacency. The short-term economic outlook is darkening, and in the medium- to long-term the economic impact of an ageing population will be felt. Staff's recommendations to improve the resilience of the economy are well-taken, and while the long-term sustainability of public finances compares favorable to the region, the authorities are fully aware of the need for further progress.