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**COMMISSION STAFF WORKING DOCUMENT**

**In-Depth Review for The Netherlands**

**in accordance with Article 5 of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances**

*Accompanying the*

**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN  
PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE  
EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF  
THE REGIONS AND THE EUROPEAN INVESTMENT BANK**

**Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery  
and modernising our economy**

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## CONTENTS

Executive summary	1
1. Assessment of Macroeconomic Imbalances	2
2. Thematic Issue: External Sector	10
3. Thematic Issue: Private Indebtedness and Housing	14

## LIST OF TABLES

Table 1.1:	Outward spillover heat map for The Netherlands	3
Table 1.2:	Assessment of Macroeconomic Imbalances Matrix - The Netherlands	7
Table 1.3:	Selected economic and financial indicators, The Netherlands	9
Table 2.1:	Selected external sector indicators, The Netherlands	12
Table 3.1:	Household debt indicators, The Netherlands	17
Table 3.2:	Selected housing indicators, The Netherlands	18

## LIST OF GRAPHS

Graph 2.1:	Thematic Graphs: External sector	13
Graph 3.1:	Thematic Graphs: Private indebtedness and housing	19
Graph 3.2:	Thematic Graphs: Private indebtedness and housing (cont.)	20

## LIST OF BOXES

Box 1.1:	Spillovers The Netherlands	5
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## EXECUTIVE SUMMARY

**The 2021 Alert Mechanism Report concluded that an in-depth review should be undertaken for the Netherlands to examine further the persistence of imbalances or their unwinding.** In February 2020, under the previous annual cycle of surveillance under the Macroeconomic Imbalances Procedure, the Commission identified “macroeconomic imbalances” in the Netherlands. These imbalances related to the large current account surplus and high private-sector debt. The analysis shows that these vulnerabilities remain. It should be noted that the context of the assessment of vulnerabilities in this year’s in-depth review (IDR) for the Netherlands is markedly different from last year. Also, the evolution of the COVID-19 pandemic, the strength of the recovery, and possible structural implications of the crisis are all still surrounded by high uncertainty, requiring caution in the assessment. In general, policy action over the past year focused on cushioning the impact of the COVID-19 shock and facilitating the recovery. This should support adjustment in the medium-term. Looking forward, the Recovery and Resilience Plan provides an opportunity to address imbalances, investment and reforms needs.

### **Main observations and findings of this IDR analysis are:**

- **This IDR is informed by the 2021 spring forecast, which expects a recovery in economic activity in the Netherlands with the easing of the COVID-19 crisis.** After the steep drop of 3.7% in 2020, real GDP is projected to increase by 2.3% this year and 3.6% next year, allowing the economy to recover its pre-pandemic level by the end of this year.
- **The current account surplus declined to 7.8% of GDP in 2020 but is expected to remain elevated.** The COVID-19 shock caused considerable shifts in sectoral positions. The savings surplus in the household and corporate sectors widened, but that was more than offset by the government sector which moved sharply into net borrowing territory due to the implementation of crisis-related fiscal support measures. Despite its recent decline, the overall savings surplus remains high both relative to fundamentals and by international comparison. Despite an ongoing pension reform and recent tax changes addressing incentives to retain earnings within SMEs, the structural drivers underpinning high household and corporate savings remain in place. The balance-of-payments picture also points to the current account surplus remaining at an elevated level going forward, as the strong recovery in global goods trade supports net exports.
- **The private debt-to-GDP ratio increased somewhat in 2020, to 235%, and is expected to remain high.** While both headline corporate and household debt levels are high, a large share of corporate debt represents intra-group debt of multinationals. Household debt is primarily driven by mortgage debt, and is expected to continue growing at a somewhat accelerated pace in nominal terms as a result of recent sharp house price rises. The maximum applicable rate of mortgage interest deductibility is being reduced by 3 percentage points per year until 2023, but a substantial subsidy for mortgage borrowing remains. Measures to discourage buy-to-let investment may further reinforce existing policy distortions favouring owner-occupancy over rental housing and thus risk undermining efforts to boost the private rental sector.

# 1. ASSESSMENT OF MACROECONOMIC IMBALANCES

## Introduction

**In February 2020, over the previous annual cycle of surveillance under the Macroeconomic Imbalances Procedure, the Commission identified “macroeconomic imbalances” in the Netherlands.** These imbalances related to the large current account surplus and high private-sector debt linked to distortions in the housing market. The 2021 Alert Mechanism Report published in November 2020 concluded that a new in-depth review (IDR) should be undertaken for the Netherlands with a view to assessing the persistence or unwinding of imbalances.

**The context of the assessment of vulnerabilities this year is markedly different from last year's IDRs, which took place before the COVID-19 pandemic.** The evolution of the pandemic, the strength of the recovery, and possible structural implications of the crisis are still surrounded by high uncertainty requiring caution in the assessment. Policy action over the past year focused on cushioning the impact of the COVID-19 shock and on facilitating the recovery. Follow-up to country-specific recommendations from 2019 and 2020, including those that are MIP-relevant, is taking place in the context of the assessment of the Recovery and Resilience Plans (RRPs). The analysis of policies in the present report was finalised before the formal submission of RRP and does not draw on information included in RRP. It is therefore without prejudice to the Commission's assessment of RRP, which is ongoing at the time of publication of this report.

**The assessment follows a similar structure as the IDRs that were included in Country Reports in recent annual cycles.** This chapter presents the main findings for the assessment of imbalances, also summarised in the MIP assessment matrix. The assessment is backed by selected thematic chapters that look more at length at the external position and private debt developments. Spillovers and systemic cross-border implications of imbalances are also taken into account. In addition, assessments of structural issues made in previous IDRs and in the context of fiscal assessments are also considered.

## Macroeconomic context

**The Dutch economy is forecast to rebound swiftly to its pre-pandemic level on the back of a robust recovery in consumer demand and more favourable external factors.** The economy is expected to grow by 2.3% and 3.6%, in 2021 and 2022, respectively, the latter also driven by strong carry-over effects. By the end of the forecast horizon, Dutch real GDP is forecast to be 2.2% above its level at the end of 2019. The output gap is set to improve significantly but still remain slightly negative, at -0.2% in 2022. Following a decline to 7.8% of GDP in 2020, the current account surplus is forecast to gradually increase to 8.7% of GDP in 2022. The gross saving rate of households is forecast to remain above its long term average of around 16%, albeit declining gradually to around 18% in 2022. The unemployment rate is forecast to remain relatively low, at 4.3% and 4.4% in 2021 and 2022, respectively, compared to 3.4% in 2019. HICP inflation is set to increase from 1.1% in 2020 to around 1½% in 2021 and 2022, reflecting a recovery in energy prices and the services sector.

**The economic recovery is expected to be broad-based, gaining steam in the second half of this year.** The implementation of the vaccination strategy and the following easing of confinement measures are set to lead to a rebound in private consumption, also to the benefit of the recovery in the contact-intensive services sector. The rebound in 2021 is also projected to be supported by robust investment dynamics on the back of a strong manufacturing sector, where previously postponed investment plans are being revived. Net exports are also expected to contribute substantially to the near-term recovery. In 2022, the pace of growth is expected to slow down in view of the expected withdrawal of the emergency support measures, a limited increase in unemployment and subdued wage growth. Risks to the outlook are broadly balanced. On the downside, possible slower pace of vaccination and new variants of the virus could delay the easing of containment measures. On the upside, stronger than projected global growth, particularly in the US, could have a more positive impact on the recovery.

## Imbalances and their gravity

**Despite its recent decline, the current account surplus remains high by international standards and relative to fundamentals.** Following a peak of 10.8% in 2018, the current account surplus narrowed slightly to 9.9% in 2019. However, it remained among the highest in the euro area as a share of GDP and is well above fundamentally justified levels. A persistently high trade surplus in goods is the main driver from a trade perspective.

**Prior to the COVID-19 shock, all domestic sectors were in surplus, with the corporate sector making the largest contribution to net lending.** Both financial corporations and non-financial corporations recorded a structural surplus, with the latter being the main driver. Net lending by non-financial corporations amounted to 4.7% of GDP in 2019. Compared to the rest of the euro area, profitability and net property income were relatively high for Dutch firms, whereas domestic investments were lower. This was linked in part to the large presence of multinationals in the Netherlands, but small and medium-sized enterprises were also significant contributors to net lending. Households have been recording surpluses since the global financial crisis, amounting to 2.3% of GDP in 2019. The dip in the housing market following the crisis initially led to a decrease in residential investment, while at the same time boosting personal savings via deleveraging pressures linked to high household debt. Pension funds were also an important driver of household net lending due to relatively high second-pillar pension contributions which are largely invested abroad. Before the COVID-19 pandemic, the government sector also recorded a headline surplus (of 1.7% of GDP in 2019), driven by past consolidation measures and increasing tax revenues.

**Private debt continued to decline in 2019, but remained high.** It reached 234% of GDP in 2019, down from 244% the year before. Non-financial corporate debt accounted for 134% of GDP. However, around 60% of this debt is owed by multinationals and largely consists of intra-group loans, implying limited macro-economic risks. The household debt ratio stood at 100% of GDP in 2019 – among the highest in euro area and well above relevant benchmarks. Although household debt continued to increase in nominal terms, growth remained relatively muted at around 1-1.5% annually since the 2008-2009 financial crisis. Household debt largely consists of mortgage debt, fuelled by mortgage interest tax deductibility coupled with distortions in the housing market, including an underdeveloped rental market and an overall housing shortage due to construction persistently falling short of demographic requirements. Real house prices continued to rise in 2019 (by 4.8% in real terms) to levels beyond what fundamentals such as income would suggest (overall valuation gap is +10% but fundamental-based gap is +20%).

**Cross-border spillovers to other EU countries are relatively moderate given the size of the Dutch economy.** Table 1.1 shows that exports to the Netherlands constitute a relatively large share of GDP for Belgium (14%). From the Dutch perspective, Germany is the largest export destination. On the financial side, Belgium, Cyprus, Ireland, Luxembourg and Malta have a relatively high exposure to the Netherlands. Box 1.1 shows an analysis of Dutch cross-border demand on other Member States' value added in 2020, confirming significant adverse impact on Belgium.

Table 1.1: Outward spillover heat map for The Netherlands

	EU partner																		
	AT	BE	BG	HR	CY	CZ	DE	DK	EE	EL	ES	FI	FR	HU	IE	IT	LT	LU	LV
Imports	1.5	14.4	1.3	0.3	0.1	3.4	3.3	2.2	2.2	1	1.4	2.3	1.4	3.4	4	0.9	3.1	6.2	1.4
Imports (in value added)	0.63	2.65	0.61	0.49	0.37	0.77	0.8	0.65	0.62	0.26	0.45	0.52	0.47	0.81	1.35	0.27	0.69	2.51	0.6
Financial liabilities	15.4	73.2	4	1	153.6	8.9	22.6	9.5	2.8	1.2	9.7	17.1	21.8	2.4	145.6	8.2	3.7	1500.1	2.7
Financial assets	23.2	50.5	10.4	8.09	130.3	16.5	21.1	12.2	7.23	6.32	19.1	17.6	16.1	17.2	103	7.82	5.15	809	2.95
Liabilities (to banks)	1.9	5.6					2.2			0.2	1.6	1.9	4.3		0.5	1.4			
Bank claims	2.71				6.237		5.5	1.31		0.85	3.91	3.8	4.19		9.621	1.41		49.417	4.64

(1) cross-border figures for Netherlands, expressed as a % of the GDP of the partner country. The darkest shade of red corresponds to percentile 95 and the darkest shade of green to percentile 5. The percentiles were calculated for each variable based on the full available sample of bilateral exposures among EU countries. The blank spaces represent missing data. Data refer to: Imports - 2018, Imports (in value added) - 2015, Financial liabilities - 2018, Financial assets - 2018, Liabilities (to banks) - 2020-Q3, Bank Claims - 2020-Q3.

Source: IMF, OECD, TiVA, BIS and Commission services

## Evolution, prospects and policy response

**The current account surplus declined further to 7.8% of GDP in 2020 but is expected to increase somewhat again in the coming years.** The COVID-19 shock caused considerable shifts in sectoral

positions. The savings surplus in the private sector widened as household savings were boosted by curtailed consumption combined with income support measures, and the corporate sector's savings surplus also slightly increased as firms cut back both earnings distributions and investment. However, this was more than offset by the government sector which sharply moved into net borrowing territory due to fiscal support measures. Despite its recent decline, the overall savings surplus remains high both relative to fundamentals and by international comparison. The structural drivers underpinning high household and corporate savings remain in place, notwithstanding the ongoing reform of the second-pillar pension system and recent tax reforms addressing incentives to retain earnings within SMEs. The balance-of-payments picture also points to a somewhat wider current account surplus going forward, as the strong recovery in global goods trade supports net exports.

**The private debt-to-GDP ratio increased somewhat in 2020, to 235%, and is expected to remain high.** In nominal terms, household debt growth appears likely to pick up somewhat as a result of sharp house price rises in recent years, and in particular in 2020, when price growth accelerated again (to 7.3% in real terms as of Q3). However, the household debt-to-GDP ratio is likely to remain roughly stable over the next few years due to denominator effects, as economic activity gradually recovers from the COVID-19 crisis. In terms of policy measures, the maximum applicable rate of mortgage interest deductibility is being reduced by 3 percentage points per year. However, the eventual rate of 37%, to be reached in 2023 still implies that a substantial subsidy for mortgage borrowing remains. Measures to discourage buy-to-let investment may further reinforce existing policy distortions favouring owner-occupancy over rental housing and thus risk undermining efforts to boost the private rental sector. This could further increase upwards price pressure for owner-occupied homes.

### Overall assessment

**The Netherlands has recorded persistently large current account surpluses and high private debt levels.** The headline current account surplus is largely driven by non-financial corporations, with relatively high savings and low domestic investment. Both large corporations, including multinationals, and small and medium-sized enterprises have substantial surpluses. Households also make a sizable contribution (particularly when correcting for statistical distortions linked to the treatment of retained earnings), among other things due to high mandatory pension contributions. Household debt as a share of GDP is around 50 percentage points higher than the euro area average and well above the relevant benchmarks (see subsection 4.2.3), as tax incentives encourage households to take on mortgage debt. While household debt is coupled with substantial housing and pension assets, these assets are often illiquid, leaving households vulnerable to shocks.

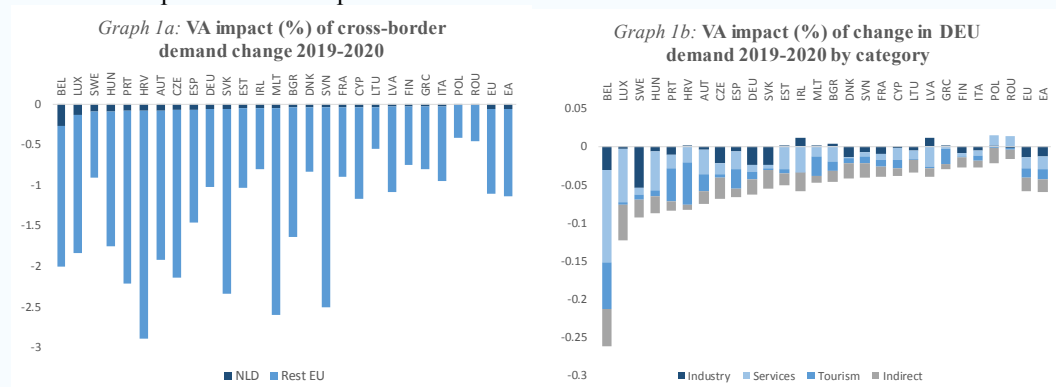
**The external surplus and private debt level are expected to remain elevated.** The current account surplus is expected to remain well above the threshold, as the strong recovery in global goods trade supports net exports and the structural factors underpinning high private-sector savings surpluses remain in place. Household debt is expected to continue growing in nominal terms, linked to sharp house price rises. Despite recent policy steps, strong incentives to take on mortgage debt remain, also against the background of an underdeveloped private rental market.

### Box 1.1: Spillovers The Netherlands

**The pandemic recessions in EU Member States also reflected faltering cross-border demand from trade partners.** While Dutch aggregate demand only played a limited role in the overall EU cross border demand spillovers during 2020, it had significant impact on some countries. In the recovery, cross-border spillovers may undo their negative impact of 2020, yet the uncertain timing and extent of the recovery make a forward-looking assessment difficult. As a first step, this box thus aims to take stock of the heterogeneous spillovers of Dutch demand to other Member States' value added in 2020. It quantifies cross-border effects applying latest production data to input-output estimates.<sup>(1)</sup> This allows for synthesizing supply chain effects, e.g. detailing how Dutch consumption from domestic providers affected those providers' foreign suppliers, and their suppliers in turn. While these results allow for country-specific sectorial detail, it has to be noted that they reflect partial equilibrium effects in the goods and services market only – they do not include any second-round effects on foreign wage income, interest rates, prices etc., which may be stronger.

**Graph 1a shows the overall cross-border impact of the heterogeneous final demand changes during 2020, and highlights the Dutch contribution therein.** Overall, 1.2 pp of the 2020 EU output decline can be attributed to cross-border demand effects, with Dutch demand accounting for less than 0.1 p.p. thereof. Yet small open service-intensive economies were hit stronger than the average. The importance of Dutch demand varies significantly across partners, with highest relevance for neighbouring Belgium. Namely, around 0.3 p.p. of the 2 p.p. VA impact in Belgium due to intra-EU demand changes is driven by a reduction of Dutch demand. Graph 1a does not necessarily mean that Dutch demand is not important for other countries. It could indicate that they mainly sell to the Netherlands goods and services for which demand did not decrease much during the COVID-19 crisis.

**Graph 2b highlights the heterogeneous effects of the pandemic by zooming in on the Dutch contribution by sector** (the dark-blue bar in Graph 1a).<sup>(2)</sup> Unsurprisingly, the decline in Dutch tourists accounted for the bulk of Dutch demand spillovers to Croatia, Portugal, Spain, Greece and Belgium. Furthermore, changes in demand for non-tourist services resulted in negative VA spillovers to Belgium, Luxembourg and Hungary, while having a positive impact on Romania and Poland. Changes in the final demand for industry products had an impact on Sweden, Germany and some Central European economies. The indirect spillovers, which captures supply chain interlinkages, are also important for countries like Belgium or Luxembourg.<sup>(3)</sup> Such indirect cross-border spillovers is on a par with Dutch direct demand for services.



<sup>(1)</sup> The estimates derive from a two-step analysis: 1) Compiling 2020 output declines at the sector-level across the globe. For the EU Member States, detailed information for 2020 is available in Eurostat. For non-EU countries, sectoral output changes in 2020 are approximated by IMF WEO GDP changes, thus implicitly abstracting from sectoral heterogeneity; 2) Using output changes in all country-sector pairs to trace back changes in final demand, based on global supply chain interlinkages as captured by the OECD ICIO tables. The resulting set of final demand changes can then be used to simulate the impact of the COVID-19 crisis on each country-sector's value added. Two important assumptions are made to allow for such a translation of output changes into demand changes. First, the technological coefficient matrix, which captures the required amount of supplies from any sector to produce a given sector's output,



is assumed to have remained fixed since the latest ICIO data (2016). Second, the country allocation final demand for a specific sector is assumed to have remained proportional to 2016.

- (<sup>2</sup>) Distinguishing by the source of the demand allows to quantify the impact of demand changes in a certain country on VA production in all its trading partners, by type of good or service. Given the particular nature of the COVID-19 crisis, with a strong impact on hospitality sectors, the analysis distinguishes between tourism (NACE sector I), all other services (G-N excl. I) and industry (A-F).
- (<sup>3</sup>) For example, a drop in Dutch demand for German cars reduces Slovak production of engines, with a knock-on effect on Czech suppliers of engine parts.

Table 1.2: **Assessment of Macroeconomic Imbalances Matrix - The Netherlands**

	Gravity of the challenge	Evolution and prospects	Policy response
Imbalances (unsustainable trends, vulnerabilities and associated risks)			
<b>Current account balance</b>	<p>The current account surplus remains one of the highest in the euro area and well above fundamentals-warranted levels (4% of GDP, according to Commission current account 'norm' estimates). The current account was 9.9% of GDP in 2019. The Netherlands has been running a current account surplus over the last three decades. This implies a persistent gap between savings and investment, with possible adverse consequences for the allocation of resources and therefore growth and welfare, and has relevance for the euro area as a whole.</p> <p>A breakdown by institutional sector points to non-financial corporations as the largest contributor historically, with a surplus of about 4.7% of GDP in 2019. The large presence of multinationals is a significant contributor to corporate savings, but small and medium-sized enterprises also have a significant surplus, which in part appears linked to fiscal incentives to retain earnings.</p> <p>The household balance turned positive during the global financial crisis and accounts for much of the surplus widening since then. It reached 2.3% of GDP in 2019 and is boosted by relatively large mandatory pension savings.</p> <p>The government sector also had a net savings surplus in the three years before 2020.</p>	<p>Overall, the current account surplus has declined further in 2020 (to 7.8% of GDP, based on the latest available data). Despite this decline, the overall savings surplus remains high both relative to fundamentals and by international comparison.</p> <p>In terms of sectoral contributions, in 2020, the household surplus has been boosted by curtailed consumption and precautionary savings following the COVID-19 crisis. The corporate surplus has also increased as profitability has so far held up well, while companies have cut back on shareholder pay-outs to preserve liquidity and investments have been reduced due to increased uncertainty. However, more than offsetting this, the government balance fell sharply into deficit due to fiscal support measures.</p> <p>The current account surplus is expected to increase somewhat to 8.5% of GDP in 2021 and to 9% of GDP in 2022, as the strong recovery in global goods trade supports net exports.</p>	<p>The government has maintained a highly expansionary fiscal stance since the COVID-19 crisis to help support domestic demand (general government balance of -4.3% of GDP in 2020, vs +1.7% in 2019), more than offsetting the increase in the private-sector savings surplus.</p> <p>In June 2019, the social partners and government reached an agreement on principles for a significant reform of the pension system. Following continued negotiations on implementation details, the agreement is currently going through the legislative process, which is expected to be finalised by January 2023. The new framework will be gradually phased in from 2023, with full implementation anticipated by 2027 at the latest. In the meantime, pension contributions have been raised; at the margin, this implies a further increase of the household savings surplus in the near-term.</p> <p>Recent tax reforms for SMEs could reduce incentives to retain earnings, although in practice they may shift part of smaller companies' savings surplus to the household sector rather than leading to an overall reduction in the current account surplus.</p>
<b>Private debt</b>	<p>The private debt level in the Netherlands remains very high, standing at 234% of GDP in 2019.</p> <p>In particular, household debt, at about 100% of GDP in 2019, exceeds the fundamental benchmark by around 30 percentage points of GDP and the euro area average by some 50 percentage points.</p> <p>It mostly consists of mortgage debt,</p>	<p>Private debt rose slightly to 235% of GDP in 2020, after having declined somewhat in earlier years.</p> <p>Household debt has continued growing over the course of 2020 at around 1.5% in nominal terms, broadly in line with its prior trend. The COVID-19 crisis has had little impact on mortgage borrowing, as house prices continued to rise and housing market activity remained</p>	<p>The accelerated reduction in mortgage interest deductibility is being implemented, cutting the maximum applicable rate to 37% by 2023. Nonetheless, a substantial subsidy on debt-financed homeownership remains.</p> <p>Initiatives are being undertaken to boost new rental housing supply, but with</p>

(Continued on the next page)

Table (continued)

which is driven by tax incentives for (debt-financed) owner-occupied house purchases and an underdeveloped rental market. While households have a high positive net asset position due to housing and pension wealth, they remain vulnerable to financial shocks since those assets are often illiquid and subject to market risk.

House prices have been growing notably over recent years and there are signs of overvaluation risks, notably with an overall overvaluation gap of +10% as estimated by the Commission.

Non-financial corporate (NFC) debt stood at 134% of GDP in 2019 exceeding the prudential threshold (94% of GDP) and fundamental benchmark (112% of GDP). The high level of NFC debt is largely driven by intra-group debt of multinationals.

strong. House prices grew at higher rates in 2020, in fact even accelerating over the course of the year.

Although the outlook is uncertain, household debt is expected to continue growing broadly in line with its recent trajectory, driven by (possibly more moderate) house price rises going forward.

Corporate debt remained broadly unchanged in nominal terms in 2020, reflecting the offsetting effects of increased demand for credit from firms with impaired revenues to cover ongoing costs, and decreased borrowing needs for companies cutting back production and investment. Support measures have also met a significant part of firms' liquidity needs. Once these are phased out, there will likely be a rise in bankruptcies in hard-hit sectors. This could result in further tightening of credit standards for NFC lending in general and thus create renewed deleveraging pressure.

Overall, private debt as a percentage of GDP is likely to gradually decline going forward, also driven by denominator effects.

limited impact so far. Recent policy steps to discourage buy-to-let investment further reinforce the existing policy distortions favouring owner-occupancy over rental housing.

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#### Main takeaways

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- The current account balance is significantly above norms implied by the fundamentals of the Dutch economy and is one of the highest in the euro area. The persistently high gap between savings and investment has possible adverse consequences for the allocation of resources and therefore growth and welfare. In addition, external rebalancing is important from the euro area perspective. Household debt, consisting mainly of mortgage debt, is high compared to relevant country-specific fundamentals and prudential benchmarks and the euro area average. Tax incentives encourage households to take on mortgage debt, while the private rental market remains underdeveloped.
- Following a decline in recent years, the current account surplus is expected to increase somewhat, as the structural drivers supporting household and corporate savings remain in place and, from a trade perspective, the strong recovery in global goods trade supports net exports going forward. Nominal household debt keeps growing at a moderate pace amid continued house price rises.
- The acceleration of the reduction in mortgage interest deductibility between 2020 and 2023 continues to take effect, although it only affects a small part of the mortgages and a generous subsidy remains. The agreement between social partners and government on the reform of the second-pillar pension system is currently going through the legislative process and will be phased in from January 2023, with full implementation envisaged by 2027. In the meantime, pension contributions have been raised; at the margin, this implies a further increase of the household savings surplus. The current highly expansionary fiscal stance should support domestic demand.

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**Source:** European Commission Services

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Table 1.3: Selected economic and financial indicators, The Netherlands

	2004-07	2008-12	2013-18	2019	2020	forecast	
						2021	2022
Real GDP (y-o-y)	2.8	0.0	1.1	1.7	-3.7	2.3	3.6
Potential growth (y-o-y)	1.8	0.9	0.7	1.8	1.0	1.4	0.8
Private consumption (y-o-y)	0.8	-0.4	1.1	1.5	-6.4	1.1	6.5
Public consumption (y-o-y)	3.0	1.4	0.5	1.6	0.6	2.7	1.3
Gross fixed capital formation (y-o-y)	6.2	-4.1	3.6	4.6	-3.6	2.6	2.3
Exports of goods and services (y-o-y)	6.6	2.0	4.5	2.7	-4.3	6.4	5.2
Imports of goods and services (y-o-y)	6.8	1.1	4.7	3.2	-4.3	6.5	6.0
Contribution to GDP growth:							
Domestic demand (y-o-y)	2.4	-0.7	0.5	2.0	-3.4	1.7	3.5
Inventories (y-o-y)	0.0	0.0	0.1	-0.2	0.1	0.0	0.1
Net exports (y-o-y)	0.4	0.8	0.5	-0.1	-0.4	0.6	0.0
Contribution to potential GDP growth:							
Total Labour (hours) (y-o-y)	0.4	0.2	0.3	0.8	0.4	0.6	0.0
Capital accumulation (y-o-y)	0.7	0.5	0.2	0.6	0.3	0.4	0.4
Total factor productivity (y-o-y)	0.7	0.3	0.1	0.4	0.4	0.4	0.4
Output gap	-0.6	-1.2	-0.9	1.4	-3.7	-2.5	-0.2
Unemployment rate	4.9	4.8	5.9	3.4	3.8	4.3	4.4
GDP deflator (y-o-y)	2.0	1.0	1.1	3.0	2.4	1.9	1.7
Harmonised index of consumer prices (HICP, y-o-y)	1.5	1.9	1.0	2.7	1.1	1.6	1.4
Nominal compensation per employee (y-o-y)	2.3	2.5	1.1	2.9	4.9	1.5	0.9
Labour productivity (real, person employed, y-o-y)	1.7	-0.1	0.5	-0.2	-3.2	.	.
Unit labour costs (ULC, whole economy, y-o-y)	0.6	2.4	0.6	3.1	8.4	-1.0	-2.3
Real unit labour costs (y-o-y)	-1.3	1.4	-0.5	0.1	5.8	-2.9	-4.0
Real effective exchange rate (ULC, y-o-y)	-0.3	0.3	-0.2	-0.2	.	.	.
Real effective exchange rate (HICP, y-o-y)	-0.5	-0.8	0.4	0.4	1.9	0.3	-0.4
Net savings rate of households (net saving as percentage of net disposable income)	2.6	6.4	9.1	10.0	17.2	.	.
Private credit flow, consolidated (% of GDP)	12.1	7.7	5.9	0.0	.	.	.
Private sector debt, consolidated (% of GDP)	229.7	244.9	255.3	234.0	.	.	.
of which household debt, consolidated (% of GDP)	107.7	116.9	110.1	100.3	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	122.0	128.0	145.3	133.7	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (2)	.	2.4	2.3	1.7	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	9.2	9.0	7.6	5.9	6.1	7.8	8.1
Corporations, gross operating surplus (% of GDP)	27.3	27.7	27.1	26.0	26.5	27.8	27.1
Households, net lending (+) or net borrowing (-) (% of GDP)	-2.4	1.3	3.2	2.3	6.0	5.3	2.4
Deflated house price index (y-o-y)	2.4	-3.7	4.4	4.8	6.2	.	.
Residential investment (% of GDP)	6.0	4.8	3.9	5.0	5.2	.	.
Current account balance (% of GDP), balance of payments	7.7	7.2	10.0	9.9	7.8	8.1	8.7
Trade balance (% of GDP), balance of payments	8.5	8.4	10.6	10.4	10.6	.	.
Terms of trade of goods and services (y-o-y)	-0.1	-0.5	0.0	0.6	1.1	-0.3	0.2
Capital account balance (% of GDP)	-0.4	-0.3	0.0	0.0	0.0	.	.
Net international investment position (% of GDP)	-5.5	10.3	52.6	90.0	114.8	.	.
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (1)	-64.3	-73.2	-37.1	-0.5	10.6	.	.
IIP liabilities excluding non-defaultable instruments (% of GDP) (1)	326.3	387.0	384.9	358.8	368.4	.	.
Export performance vs. advanced countries (% change over 5 years)	6.9	-0.1	-3.8	-1.1	14.1	.	.
Export market share, goods and services (y-o-y)	-1.5	-2.7	0.8	-0.6	6.2	-1.4	-0.1
Net FDI flows (% of GDP)	4.6	5.8	5.8	4.7	-3.8	.	.
General government balance (% of GDP)	-0.6	-3.8	-0.6	1.8	-4.3	-5.0	-1.8
Structural budget balance (% of GDP)	.	.	-0.3	0.8	-2.0	-3.4	-1.7
General government gross debt (% of GDP)	47.1	59.7	61.2	48.7	54.5	57.9	56.8
Tax-to-GDP ratio (%) (3)	36.0	36.1	38.2	39.8	40.2	39.9	38.5
Tax rate for a single person earning the average wage (%) (4)	32.5	32.0	32.0	29.4	28.7	.	.
Tax rate for a single person earning 50% of the average wage (%) (4)	23.4	21.6	18.0	14.7	14.0	.	.

(1) NIIP excluding direct investment and portfolio equity shares

(2) domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.

(3) The tax-to-GDP indicator includes imputed social contributions and hence differs from the tax-to-GDP indicator used in the section on taxation

(4) Defined as the income tax on gross wage earnings plus the employee's social security contributions less universal cash benefits, expressed as a percentage of gross wage earnings

Source: Eurostat and ECB as of 2021-05-05, where available; European Commission for forecast figures (Spring forecast 2021)

## 2. THEMATIC ISSUE: EXTERNAL SECTOR

**The Netherlands has been recording a sizable current account surplus for more than two decades.** It reached a peak of 10.8% in 2018, before narrowing to 9.9% in 2019 and further to 7.8% in 2020 under the effect of the crisis (Table 1). The structural surplus in the balance of trade in goods accounts for nearly all of the surplus, while net exports of services and the primary income balance are much lower, though more volatile (Graph 2.1a). <sup>(1)</sup> The decline in 2020 was due to declining income account balances, both primary and secondary, that more than offset marginal improvements in the trade balance.

**The longstanding current account surplus can partly be explained by the economy's fundamental characteristics.** The current account surplus explained by the fundamentals ('current account norm') <sup>(2)</sup> equalled 4% of GDP in 2019 (Table 2.1), with important contributions coming from high per capita output (relative to other countries), as well as from the financial centre status of the Netherlands. The fact that the Dutch surplus has consistently exceeded the norm points to a number of structural factors closely linked to savings and investment decisions, including compulsory savings via the second-pillar pension system combined with mortgage repayments, relatively low construction investment and private credit growth and the comparatively high structural fiscal balance (Graph 2.1b). <sup>(3)</sup>

**Prior to the COVID-19 crisis, all institutional sectors added to the substantial net lending position of the economy.** Following a switch from net borrowing to lending by households in 2009, all private institutional sectors have consistently been recording a saving surplus, leading to an overall savings surplus between 5% and 11% of GDP over the last decade (Graph 2.1c). The government's position moved from considerable borrowing of around 5% of GDP after the financial crisis, into a surplus over the last three years before the COVID-19 pandemic. While high net lending could point to underinvestment domestically, the comparison of aggregate investment with the euro area average does not point to a significant investment gap (Graph 2.1d). <sup>(4)</sup> Thus, high net lending is primarily explained by excess savings, with some important specific drivers across the corporate and household sectors.

**The largest contribution to the headline savings surplus stems from the corporate sector.** On average, the net lending of the (non-financial) corporate (NFC) sector (Graph 2.1c), accounted for 80% of the economy's saving surplus since the early 2000s. Within the sector, the net lending of multinational enterprises (MNEs) amounted to 4% of GDP on average, exhibiting considerable volatility <sup>(5)</sup>, while the surplus of small and medium companies has been more stable, ranging between 2% and 3% of GDP. High net lending by MNEs arises due to their global profits, which are attributed to their Dutch

<sup>(1)</sup> While at least 3% of GDP of the goods surplus can be attributed to Rotterdam's role as a global trade and logistics hub (and in particular to re-exports), trade in services and primary income transactions are partly related to activities of multinational enterprises (MNEs), i.e. their intra-group payments. For more details, please see Suyker, W., Wagteveld, S. (2019), A Fresh Look at the Dutch Current Account Surplus and its Driving Forces, CPB (Netherlands Bureau for Economic Policy Analysis), The Hague.

<sup>(2)</sup> 'Current account norm' is the current account balance that can be explained by fundamentals. It is based on an empirical setup similar to IMF's EBA (Phillips, S., Catão, L., Ricci, L., Bems, R., Das, M., Di Giovanni, J., Unsal, D.F., Castillo, M., Lee, J., Rodriguez, J., and Vargas, M. (2013), "The external balance assessment (EBA) methodology", International Monetary Fund Working Paper 13/272). Fundamentals are slow-moving variables including, e.g. natural resources, demographics, or relative income. For details see Coutinho, L., Turrini, A., Zeugner, S. (2018), "Methodologies for the assessment of current account benchmarks", European Economy, Discussion Paper 86/2018..

<sup>(3)</sup> The structurally high current account surplus has also led to an elevated net international investment position (NIIP). The Dutch NIIP turned positive in 2009 and has increased to 90% of GDP by 2019, driven by the accumulated current account surpluses. The NIIP excluding the non-defaultable instruments (NENDI) is balanced, so that the excess of external assets over liabilities is due to the equity component. However, gross external assets and liabilities exceed GDP tenfold (amounting to 1171% and 1056% of GDP, respectively) due to strong MNEs presence.

<sup>(4)</sup> The same holds true also for the general government investment specifically. Importantly, although at a macro level there is no underinvestment relative to peer countries, there are some ad hoc and industry-specific investment challenges in some areas, for instance linked to the 'nitrogen problems' affecting various sectors, including the construction industry. For more details, see European Commission (2020), Country Report The Netherlands 2020, Commission Staff Working Document SWD(2020) 518 final, Publications Office of the European Union, Luxembourg, subsection 4.4 and box 4.4.1 in particular.

<sup>(5)</sup> This volatility is largely due to a single MNE in the oil sector which pays a fixed dividend to shareholders, implying that oil price swings translate into net savings and retained earnings figures almost mechanically. Please see European Commission (2020), "Interpreting external sector statistics: taking into account the role of financial globalization and MNEs", Note for the attention of the EPC LIME Working Group, January.

headquarters, even though these are largely being retained and invested abroad. Thus, their (global) earnings exceed (domestic) investment leading to a structural saving surplus. As for the small and medium companies, especially those with just a few shareholders, they typically distribute only a small portion of their profits, likely due to fiscal incentives to retain earnings and defer or avoid tax payments.<sup>(6)</sup>

**Households' net lending position turned positive after the global financial crisis.** On average, it equalled slightly less than 3% of GDP since 2009. Its evolution was driven by housing market developments (low housing investment following the crisis and substantial deleveraging of households), relatively weak wage and disposable income growth following the 2008-2009 financial crisis and large savings in the form of relatively high (second-pillar) pension contributions, which are widely invested abroad (European Commission, 2020). The pension savings aspect is of a more structural nature and also reveals that the contribution of households to the overall savings surplus is higher than recorded in the headline statistics on sectoral net lending. This is because the Dutch pension funds, whose ultimate beneficiaries are households, are large portfolio investors in foreign companies with substantial retained earnings that remain attributed to their home country in national accounts until they are distributed.<sup>(7)</sup> Even without adjusting for these statistical distortions, the household (gross) saving rate was consistently higher than the saving rate of the euro area following the global financial crisis, with the difference exceeding 3 percentage points of gross disposable income over most of the period (Graph 2.1e).<sup>(8)</sup>

**The Covid-19 shock caused considerable shifts in sectoral positions, but overall net lending remained large in 2020.** The general government moved to a substantial deficit related to fiscal support measures, mainly to paid subsidies on production. As a result, the government sector net borrowing amounted to 4.3% of GDP in 2020, versus net lending of 1.7% of GDP in 2019. This decline has partly been offset by a higher household savings surplus, which rose from 2.3% to 6.0% of GDP in 2020, mostly due to higher savings amid a strong decline in consumption (especially in 2020Q2), but partly also due to increased disposable income (mainly linked to support measures). Over the same period, the NFCs' saving surplus expanded from 4.7% to 5.7% of GDP, despite a large negative contribution from the oil sector amid low oil prices (see also footnote 5). The overall corporate sector recorded a milder increase from 5.9% to 6.1%, as financial corporations' surplus declined to 0.4% of GDP in 2020, versus 1.1% in 2019. The NFCs' operating surplus slightly increased (in nominal terms) during 2020, supported by higher subsidies on production, which more than offset the decline in their value-added. Their savings recorded a stronger increase as companies cut back shareholder pay-outs to preserve liquidity and investments have been reduced due to increased uncertainty.<sup>(9)</sup> Based on the Commission Spring Forecast, the corporate net lending position is projected to remain large at roughly the same levels as before the COVID-19 pandemic. Household and general government positions are expected to gradually move toward their pre-crisis levels, so that the overall net lending position should increase somewhat over the forecast horizon.

**The impact of recent policy steps on the structural drivers of the savings surplus is uncertain.** An agreement between social partners and government on a major reform of the second-pillar pension reform is currently going through the legislative process and will be phased in from January 2023, with full implementation envisaged by 2027. While this addresses some key challenges with the existing system and lays the groundwork for more individual flexibility, it will not directly reduce the high level of compulsory household savings via the pension system.<sup>(10)</sup> Moreover, in the meantime, pension

<sup>(6)</sup> For more details, please see European Commission (2020), Country Report The Netherlands 2020, Commission Staff Working Document SWD(2020) 518 final, Publications Office of the European Union, Luxembourg, and De Nederlandsche Bank (DNB) (2019), Het Spaaroverschot van Nederlandse Bedrijven Ontrafeld, DNB Occasional Study Volume 17-4 9 december 2019, Amsterdam.

<sup>(7)</sup> There is a roughly offsetting effect for Dutch MNEs, which often have an internationally diversified shareholder base. For more details on this and other statistical discrepancies in the allocation of net lending across sectors, please see European Commission (2020), Country Report The Netherlands 2020, Commission Staff Working Document SWD(2020) 518 final, Publications Office of the European Union, Luxembourg. In addition, the aforementioned fiscal incentives to retain profits in small and medium companies also artificially shifts a part of the saving surplus to the corporate instead to household sector.

<sup>(8)</sup> While the investment rate of households also exceeded the corresponding rate for the euro area for most of the last decade, the difference was smaller on average, but increasing to more than 3 percentage points in 2019.

<sup>(9)</sup> As for the financial corporations, their position was mainly affected by the decline in net (received minus paid) distributed income of corporations.

<sup>(10)</sup> From a policy perspective, high compulsory savings via the pension system (in combination with mortgage repayments) is a key structural driver of the high household savings surplus. It can also lead to suboptimal consumption smoothing across different lifetime phases. Pension premiums are generally set as a fixed contribution percentage (typically around 20%) of gross

contributions have actually been raised in 2020; this implies a further increase of the household savings surplus in the near-term. With regard to the corporate sector, some recent tax reforms <sup>(1)</sup> could help address incentives for SMEs favouring the accumulation of retained earnings within the company. However, in practice this may shift part of small companies' savings surplus to the household sector. The overall impact on the savings surplus therefore remains uncertain.

Table 2.1: Selected external sector indicators, The Netherlands

		2003-07	2008-12	2013-17	2018	2019	2020	2021f	2022f
<b>Flows <sup>(1)</sup></b>									
CA balance as % of GDP, NA	Source: (b)	6.1	7.2	9.0	10.8	9.9	7.8	8.1	8.6
CA balance as % of GDP, BoP	(a)	7.3	7.2	8.7	10.8	9.9	7.8	8.1	8.6
Cyclically adj. CA balance as % of GDP <sup>(2)</sup>	(c)	4.7	7.1	8.1	10.8	10.0	10.6	8.9	9.1
CA req. to stabilize NIIP above -35% <sup>(3)</sup>	(c)	-0.1	0.1	1.5	1.9	2.1	2.4	3.5	3.4
CA explained by fundamentals (CA norm) <sup>(4)</sup>	(c)	3.6	4.5	4.0	4.1	4.0	4.0	3.7	3.6
Required CA for specific NIIP target <sup>(5)</sup>	(c)	2.6	2.6	1.7	1.1	0.6	-0.1	-0.6	-0.8
Trade bal. G&S, % of GDP, NA	(b)	7.7	8.5	10.0	10.5	10.4	10.6	10.7	10.5
Required TB for specific NIIP target <sup>(5)</sup>	(c)	1.4	2.0	1.9	2.7	2.2	1.6	1.3	1.1
<b>Stocks</b>									
NENDI as % of GDP	(a)	-67	-73	-44	-17	0	11		
of which: net portfolio debt	(a)	-66	-101	-87	-59	-50	-39		
of which: net mutual fund shares	(a)	9	23	33	33	35	36		
of which: net other investment	(a)	-13	-7	-1	0	1	-6		
NIIP as % of GDP	(a)	-5	10	50	72	90	115	117	117
Prudential NIIP/NENDI benchmark	(c)	-88	-90	-87	-89	-89	-88	-89	-88
Fundamentally expl. NIIP benchmark (NIIP norm)	(c)	17	27	42	45	48	50	48	47
Gen. Government NIIP	(a)	-28	-34	-28	-19	-18	-20		
Private Sector NIIP	(a)	-40	-26	-9	-1	-10	-19		
of which: Net FDI <sup>(6)</sup>	(a)	11	22	44	49	51	46		
MFI (excl CB) NIIP	(a)	-41	-60	-49	-36	-27	-19		
Oth. financials NIIP	(a)	100	112	122	116	138	168		
Central bank NIIP	(a)	4	17	15	11	7	5		
of which: Reserves	(a)	3	5	5	4	5	5		
of which: Target2	(a)		10	8	12	6	5		
<b>Value-added trade and capital account</b>									
VA imports % of agg. demand <sup>(7)</sup>	(d)	33	37	41					
Capital account bal. as % of GDP, NA	(b)	0.1	-0.5	-0.2	-0.1	0.0	0.0	0.0	0.0
<b>Indicators in % of potential GDP</b>									
CA balance as % of potential GDP, NA	(b,c)	6.1	7.0	8.8	11.0	10.1	7.5	7.9	8.6
CA balance as % of potential GDP, BoP	(a,c)	7.2	7.1	8.6	11.0	10.1	7.5	7.9	8.6
Cyclically adj. CA balance as % of potential GDP	(c)	4.6	7.0	8.0	10.9	10.1	10.2	8.7	9.0
Trade bal. G&S, as % of potential GDP, NA	(b,c)	7.6	8.4	9.8	10.7	10.6	10.2	10.5	10.5
NENDI as % of potential GDP	(a,c)	-67	-72	-43	-17	0	10		
NIIP as % of potential GDP	(a,c)	-5	10	49	73	91	111	114	117
Capital account bal. as % of potential GDP, NA	(b,c)	0.1	-0.5	-0.2	-0.1	0.0	0.0	0.0	0.0

(1) Flow data refer to national account concept, unless indicated otherwise.

(2) Cyclically adjusted CA is the CA adjusted for the domestic and foreign output gaps, taking into account trade openness.

(3) The average CA needed in order to stabilise the NIIP is based on T+10 Econ projections.

(4) The CA explained by fundamentals refers to the expected CA given the level of its fundamentals with respect to world average.

(5) The CA or TB needed either to halve the distance to fund. NIIP benchmark, or to reach the prud. NIIP benchmark in 10Y, whichever is higher. Based on T+10

(6) In case private-sector FDI is not available, total economy FDI is displayed.

(7) VA imports as % of aggregate demand describes the % of aggregate demand that is sourced from foreign value added.

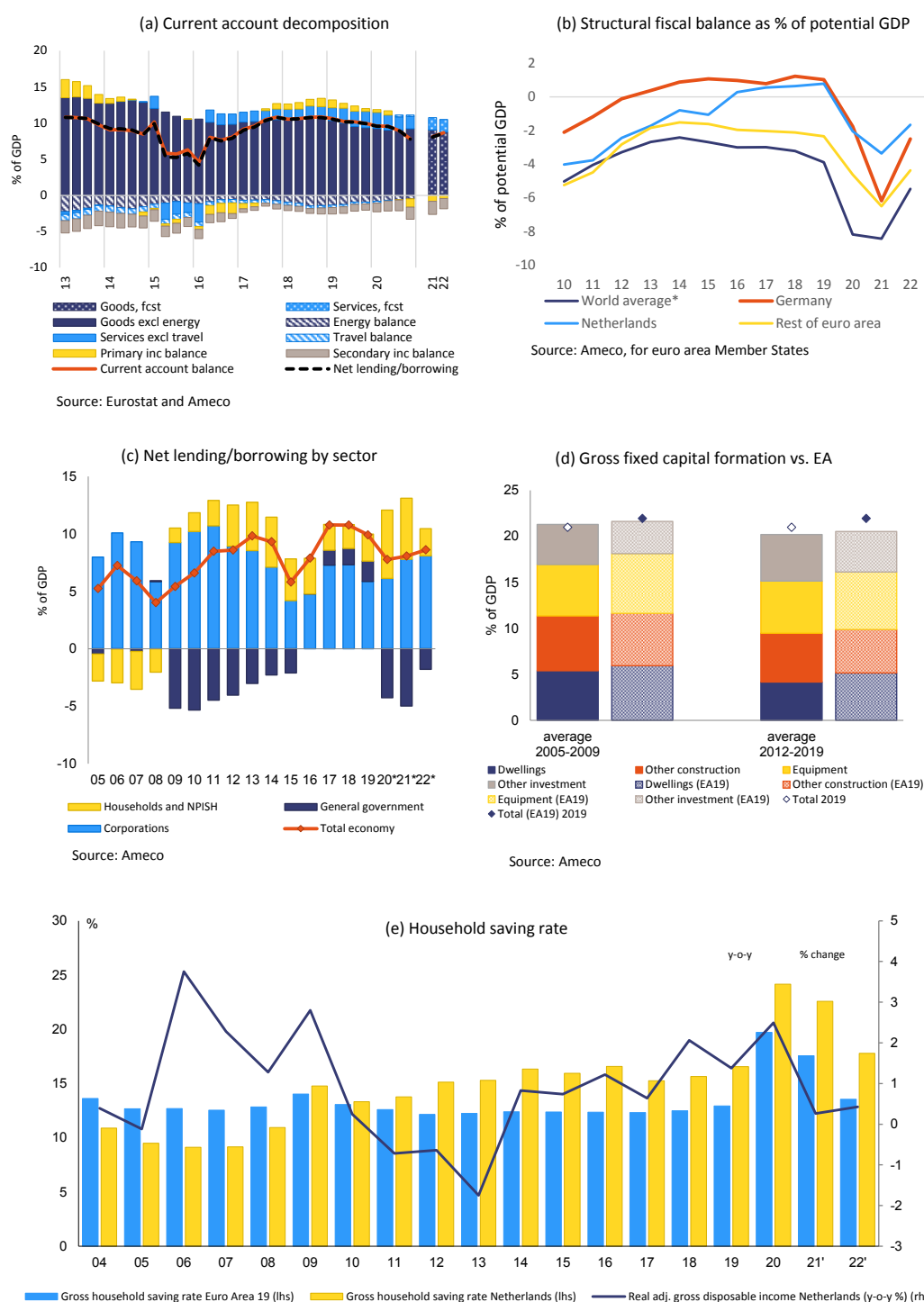
**Source:** (a) Eurostat, (b) Ameco, (c) European Commission calculations, (d) WIOD database.

earnings. For more details, please see European Commission (2020), Country Report The Netherlands 2020, Commission Staff Working Document SWD(2020) 518 final, Publications Office of the European Union, Luxembourg, subsections 4.2.5 and 4.2.6.

<sup>(1)</sup> These include the phasing out of tax-advantaged internally managed pension plans ('*Pensioen in eigen beheer*') since 2017, and making large debts owed by controlling shareholders to their companies partially subject to tax from 2022.



Graph 2.1: Thematic Graphs: External sector



Source: European Commission Services



### 3. THEMATIC ISSUE: PRIVATE INDEBTEDNESS AND HOUSING

#### Overall situation

**The private debt-to-GDP ratio continued to decline until 2019 but increased somewhat in 2020.** High private debt has been a long-standing challenge for the Netherlands. It reached 234% of GDP in 2019, down from 244% the year before. Preliminary data for 2020 suggest that it saw a slight increase (to 235% of GDP in Q4 2020). Both household debt and corporate debt are among the highest in the EU relative to GDP and well above relevant benchmarks (see Graphs 3.1(a) and 3.1(b)). Household debt (consolidated) stood at 100% of GDP in 2019 (103% in Q4 2020), above both the prudential threshold (61% of GDP) and fundamental benchmark (77% of GDP).<sup>(12)</sup> Non-financial corporate debt amounted to 134% of GDP in 2019 (131% of GDP in Q4 2020), exceeding the prudential threshold (94% of GDP) and fundamental benchmark (112% of GDP). However, around 60% of this debt is owed by multinationals. As multinationals' debt largely consists of intra-group debt, the macro-economic risks appear to be limited. Therefore, household debt represent the main reason for concern.

**While the COVID-19 crisis has reinforced some existing vulnerabilities, its overall impact on the private debt stock is still uncertain.** The COVID-19 shock reversed the decline of private debt observed in previous years. However, the increase of debt-to-GDP ratios in 2020 was driven by the contraction of GDP by 4%, with the nominal debt stock actually declining somewhat. While there was a slight pick-up in non-performing loans (NPLs), they remained at a very low level and overall financial stability has not been affected so far (see below). Although this is partly linked to temporary support measures and debt moratoria and there remains some broader macroeconomic uncertainty following the COVID-19 crisis, at the current juncture the vulnerabilities associated with the high private debt stock do not pose an immediate significant risk to financial stability.

#### Household debt

**Household debt as a share of GDP declined in 2019 but increased significantly in 2020.** The net credit flow to households stood at 1.2% of GDP in 2019 and is estimated at 1.3% for 2020 (Table 3.1). While robust real GDP growth and inflation contributed to passive deleveraging in 2019 (Graph 3.1(c)), the GDP decline in 2020 drove an increase of the household debt-to-GDP ratio by around 3 p.p. The stock of household debt consists mainly of mortgage debt and there the COVID-19 pandemic has only had a limited impact as house prices continued to rise (see details below). By contrast, consumption loans experienced a major decline in 2020, but they represent only a small fraction of total household borrowing (Graph 3.1(d)). Therefore, the overall credit flow to households remained positive and even slightly accelerated. At the same time, there has been a significant increase in household savings as the COVID-19 pandemic containment measures constrained consumption (Graphs 3.1(e)). The ratio of household debt to gross financial assets has been on a long-term declining path (29% in 2019), which is likely to continue.

**Policy distortions underpin the high household debt stock.** High mortgage debt has been driven by long-term policy distortions in the housing market (see below) and tax incentives for mortgage borrowing. In particular, mortgage interest on owner-occupied homes is treated as a fully deductible expense in income taxation. Dutch authorities have taken some steps to limit this, both by disqualifying new interest-only mortgages from tax deductibility (in force since 2013) and by reducing the maximum applicable rate at which mortgage interest is deductible. However, this reduction only affects households in the top tax bracket (some 10% of the labour force) and the eventual rate of 37% (to be reached in 2023) still signifies a strong implicit subsidy on mortgage borrowing.

<sup>(12)</sup> Country-specific prudential thresholds are the values beyond which countries are deemed more vulnerable to crises given characteristics such as relative income, public debt, and the ratio of regulatory bank capital to risk-weighted assets. Fundamentals-based benchmarks are derived from regressions capturing the main determinants of credit growth (e.g. expected growth, house prices, unemployment) and taking into account a given initial stock of debt.

**Financial stability risks from elevated household debt appear contained.** While the share of household debt on gross disposable income stands at 200%, almost double than on GDP, NPLs on Dutch mortgages have historically remained very low, even during major macroeconomic and housing market downturns, e.g. following the 2008-2009 financial crisis. The impact of the COVID-19 crisis on mortgage loan performance has so far been very limited as well, in part thanks to income support measures and mortgage moratoria. Once these are wound down, some households may face repayment difficulties. However, the crisis has disproportionately affected lower-income workers (who tend not to be home-owners) and the impact on employment has been very limited so far. Furthermore, Dutch banks entered the crisis with robust capital levels (the Tier 1 ratio stood at 18.9% in 2019) and house prices are expected to continue growing, contrary to the financial crisis. Therefore, near-term risks to financial stability from elevated household debt appear limited.

### Corporate debt

**Despite the COVID-19 shock, corporate debt appears to have remained broadly stable relative to GDP in 2020.** Following active NFC deleveraging in 2019, which was also supported by inflation (see Graph 3.1(f)), there was a sharp pick-up in short-term borrowing and bond issuance in early spring 2020 due to acute liquidity needs and precautionary build-up of financial reserves. Preliminary data indicate this has more than reverted back in the second half of 2020, ultimately leaving NFC borrowing somewhat below the 2019 level in nominal terms (see Graph 3.1(c)). Overall, this reflects the offsetting effects of increased demand for credit from firms with impaired revenues to cover ongoing costs, and lower borrowing needs as firms cut back production and investment. In addition, government support measures and moratoria granted by banks have met a significant part of firms' liquidity needs. In terms of credit supply, banks have also tightened their lending standards for corporates (see Graph 3.2(a)).

**While the corporate debt-to-GDP ratio is rather high, a significant share of corporate debt is intra-group debt of multinational companies.** The headline debt ratios overstate actual exposure, as about 60% of total NFC debt is linked to multinationals and consists largely of intragroup debt. When this is excluded, corporate debt levels are not particularly high by international comparison and relative to relevant benchmarks. <sup>(13)</sup>

**Despite the impact of the COVID-19 crisis, vulnerabilities associated with corporate debt appear unlikely to raise immediate financial stability concerns.** So far, the crisis has had limited impact thanks to support measures and moratoria, with the corporate bankruptcy rate in 2020 actually significantly lower than in 2019. Once these are phased out, there may be a rise in bankruptcies and credit losses for banks. While the overall NPL ratio (to total loans and advances) remains low in a cross-country comparison, the NPL ratio for NFCs has already started to increase (from 1.5% in Q1 2020 to 2% in Q3). This could contribute to further tightening of credit standards for NFCs beyond that observed in 2020 (Graph 3.2(b)) and thus create renewed deleveraging pressure. However, in light of the comparatively small bank exposure to riskier corporate lending (e.g., total SME lending represents about 7% of overall banking assets) and their robust capital levels, risks to financial stability from NFC debt seem contained as well.

### Housing market

**House prices have been growing sharply over the past year and there are signs of overvaluation.** Real house prices started to recover in 2013 and were gradually accelerating until 2018 (7.1% YoY growth), and following a slowdown in 2019 (4.8%), house price growth (7.3% in 3Q) and market activity picked up again in 2020 (Graph 3.2(c)). In addition to the impact from the COVID-19 shock (see below), house price growth was likely also boosted by transfer tax changes: a rise in transfer taxes for buy-to-let investors from January 2021 led to a spike in investor demand in the second half of 2020, and the abolishment of transfer taxes for younger households from the same date subsequently increased the bidding power of this cohort. There has been some regional differentiation and, in a break with long-standing prior trends, growth has been stronger outside the major cities in 2020. Valuation metrics suggest that prices in the Netherlands are getting into overvaluation territory (Graph 3.2(d)), and beyond

<sup>(13)</sup> For more details, please see European Commission (2020), Country Report The Netherlands 2020, Commission Staff Working Document SWD(2020) 518 final, Publications Office of the European Union, Luxembourg, subsection 4.2.3.

what fundamentals such as income would suggest (overall valuation gap is +10% but fundamental-based gap is +20%).

**Following the COVID-19 shock, house price growth has accelerated.** On the demand side, mortgage rates further declined and household disposable income increased due to supportive policy measures. As in other countries, households may gradually shift their preferences in favour of more time spent at home, inducing willingness to spend a higher share of their incomes on housing and/or to purchase larger homes away from major urban centres, thus pushing up house price growth in regional locations in particular. Moreover, increased demand can come also from investors facing uncertainty and lack of alternative investment opportunities. There was indeed a strong increase in investor interest following the COVID-19 outbreak, with the share of owner-occupied homes bought by private landlords nearly doubling from pre-COVID-19 levels towards the end of 2020, although this was primarily driven by the transfer tax changes mentioned above. On the supply side, the COVID-19 shock appears to have had limited impact, as housing completions and starts were broadly in line with pre-crisis expectations and residential building permits picked up in 2020 (Graph 3.2(e)).

**Several structural factors contribute to upward pressure on house prices.** The short-term developments discussed above were coupled with some long-term factors underpinning high housing prices. On the demand-side, there is favourable tax treatment of owner-occupied housing via mortgage interest deductibility in personal income taxation as well as owner-occupied homes not normally being subject to asset taxation under ‘box 3’.<sup>(14)</sup> At the same time, there is a lack of suitable alternatives to owner-occupancy due to an underdeveloped rental market. On the supply side, while the share of residential investment on GDP has been increasing for several years (Graph 3.2(e)), housing construction has fallen short of demographic requirements since the housing market downturn following the 2008 crisis. This is linked to unaddressed capacity shortages in the construction sector and planning constraints.<sup>(15)</sup>

**While house price growth is expected to slow down, upward pressure on house prices remains.** The negative income impact of the crisis was to a large extent cushioned by support measures (GDI of households increased by about 5% in 2020). However, the crisis disproportionately affected lower-income households, who tend to be tenants rather than home-owners. Moreover, some households will exit the crisis with additional savings resulting from curtailed consumption. The aforementioned structural factors supporting house prices are also set to remain in place. Overall, house prices are therefore likely to continue growing, albeit at a slower pace. While this does not represent a major immediate risk for financial stability, the combination of high household debt and house prices diverging from fundamentals points to long-term vulnerabilities. High house prices in the owner-occupier market combined with and underdeveloped private rental sector also represent a significant burden for younger and middle-income households.

**The Netherlands has taken policy steps to discourage buy-to-let investment.** As mentioned above, the transfer tax for private landlords has been raised from 2% to 8% of the property value from January 2021 (while for owner-occupiers up to 35 years old it has been abolished<sup>(16)</sup>). In addition, rent increases (Graph 3.2 (f)) in the private rental sector have been capped, and legislation is under preparation allowing municipalities to ban buy-to-let purchases for a five-year period. These measures may further reinforce the existing policy distortions favouring owner-occupancy over rental housing and risk undermining efforts to boost the availability of private rental housing for middle-income households.

<sup>(14)</sup> For more details, please see European Commission (2020), Country Report The Netherlands 2020, Commission Staff Working Document SWD(2020) 518 final, Publications Office of the European Union, Luxembourg, p. 34-35.

<sup>(15)</sup> For more details, please see European Commission (2020), Country Report The Netherlands 2020, Commission Staff Working Document SWD(2020) 518 final, Publications Office of the European Union, Luxembourg, subsection 4.2.4.

<sup>(16)</sup> From April 2021, this will only be the case for purchases below EUR 400,000; for properties above this price level, the standard 2% transfer tax will apply.

Table 3.1: Household debt indicators, The Netherlands

		2003-07	2008-12	2013-17	2019	2020	2021f	20Q2	20Q3	20Q4
	Source									
<b>Stocks</b>										
Debt, consolidated (% of GDP)	(a,d)	106	117	110	100	103		102	103	103
Debt, consolidated (% of potential GDP)	(a,b,d)	105	115	109	102	100		100	100	100
Prudential threshold (% of GDP) <sup>(1)</sup>	(c)	51	48	57	65	61	61			
Fundamental benchmark (% of GDP) <sup>(1)</sup>	(c)	69	75	77	73	77	77			
Debt (% of gross disposable income)	(a,b,d)	209	234	220	204	200		201	201	200
Interest paid (% of gross disposable income) <sup>(3)</sup>	(a,b)	6.6	5.6	2.1	1.7			1.2	1.0	
Debt (% of gross financial assets)	(a,d)	43.0	43.4	34.1	29.0			27.0	27.0	26.8
Share of variable rate loans for house purchase (%)	(d)	27.2	21.1	17.1	18.7	15.1				
Domestic loans in forex (% of dom. loans)	(d)	0.1	0.2	0.2	0.1	0.1				
<b>Flows</b>										
Credit flows (transactions, % of GDP) <sup>(4)</sup>	(a)	7.3	3.0	0.6	1.2	1.7	0.5	2.1	2.5	2.0
Benchmark for flows (% of GDP)	(c)	3.7	2.5	1.5	2.0	2.0	1.9			
Savings rate (% gross disposable income)	(b)	9.9	13.6	15.8	16.6	23.3	22.6			
Investment rate (% gross disposable income)	(b)	14.4	11.8	10.3	13.0	13.1	13.2			
p.m. Bank HH NPLs (% of HH loans) <sup>(2)</sup>	(d)			1.5						

(f) European Commission forecast

(1) Benchmarks for flows (% of GDP) are estimated on the basis of non-consolidated flows.

(2) Gross non-performing bank loans and advances to Households and non profit institutions serving households (% of total gross bank loans and advances to Households and non profit institutions serving households).

(3) Quarterly data is annualized.

**Sources:** (a) Eurostat, (b) Ameco, (c) European Commission calculations, (d) ECB.

Table 3.2: Selected housing indicators, The Netherlands

			2003-07	2008-12	2013-17	2018	2019	2020	20Q1	20Q2	20Q3	20Q4
<b>House price developments</b>	Unit	Source										
Real house price, yoy growth	%	(a)	2.0	-3.6	1.2	7.1	4.8	6.3	4.3	5.3	7.7	7.2
Nominal house price, yoy growth	%	(a)	4.1	-2.5	2.2	9.5	7.3	7.6	6.3	7.1	8.4	8.7
Price to income in level <sup>(1)</sup>	years	(b)	12.6	11.8	10.2	11.5	11.9	12.0	12.6	10.7	12.7	12.1
<b>Valuation gaps</b>												
Price to income gap <sup>(2)</sup>	%	(c)	13.9	7.5	-7.2	4.1	8.0	8.8	7.2	7.9	9.4	10.1
Price to rent gap <sup>(2)</sup>	%	(c)	15.9	9.1	-13.5	-1.9	2.7	7.6	4.7	6.5	8.8	9.8
Model valuation gap <sup>(3)</sup>	%	(c)	12.6	9.5	-5.9	6.0	9.8	18.0	14.1	16.8	19.6	20.8
Average house price gap <sup>(4)</sup>	%	(c)	14.1	8.7	-8.8	2.7	6.9	11.5	8.7	10.4	12.6	13.6
<b>Housing credit</b>												
Mortgages (% GDP)	%	(d)	62.0	58.0	61.5	61.8	60.4	61.9				
Mortgages, yoy growth	%	(d)	4.5	0.5	4.6	-0.5	2.3	1.1				
<b>Housing supply</b>												
Residential construction - dwellings (% GDP)	%	(e)	5.9	4.9	3.6	4.9	5.0	5.2				
Residential construction - dwellings, yoy growth	%	(e)	5.6	-9.3	9.6	9.3	1.6	-2.7				
Non-residential construction (% GDP)	%	(e)	5.6	5.9	5.3	5.3	5.5	5.7				
Value added in the construction sector, yoy growth	%	(e)	4.6	-3.9	4.1	4.8	5.1	-0.8				
Building permits, yoy growth	%	(a)	5.8	-15.0	16.6	2.7	-19.0	12.6				
Number of transactions, yoy change	%	(f)	1.9	-9.6	17.5							
<b>Other housing market indicators</b>												
Share of owner-occupiers, with mortgage or loan	%	(a)	56.4	59.6	60.2	60.5	60.4	60.8				

(1) Forecast. The forecast of house prices is computed on the basis a housing valuation model shared with Member States in the context of the EPC LIME working group. The forecasts represent real house price percentage changes expected based on economic fundamentals (population, disposable income forecast, housing stock, long-term interest rate, and the price deflator of private final consumption expenditure), as well as the error correction term summarising the adjustment of prices towards their long-run relation with fundamentals. The source for the forecast of other variables is Ameco.

(1) Price to income in level is the number of years of income necessary to buy an assumed 100m2 dwelling. See Bricongne, J-C, A Turrini, and P Pontuch, 2019, "Assessing House Prices: Insights from HouseLev, a Dataset of Price Level Estimates", Discussion Paper 101, European Commission, available in "[https://ec.europa.eu/info/publications/assessing-house-prices-insights-houselev-dataset-price-level-estimates\\_en](https://ec.europa.eu/info/publications/assessing-house-prices-insights-houselev-dataset-price-level-estimates_en)".

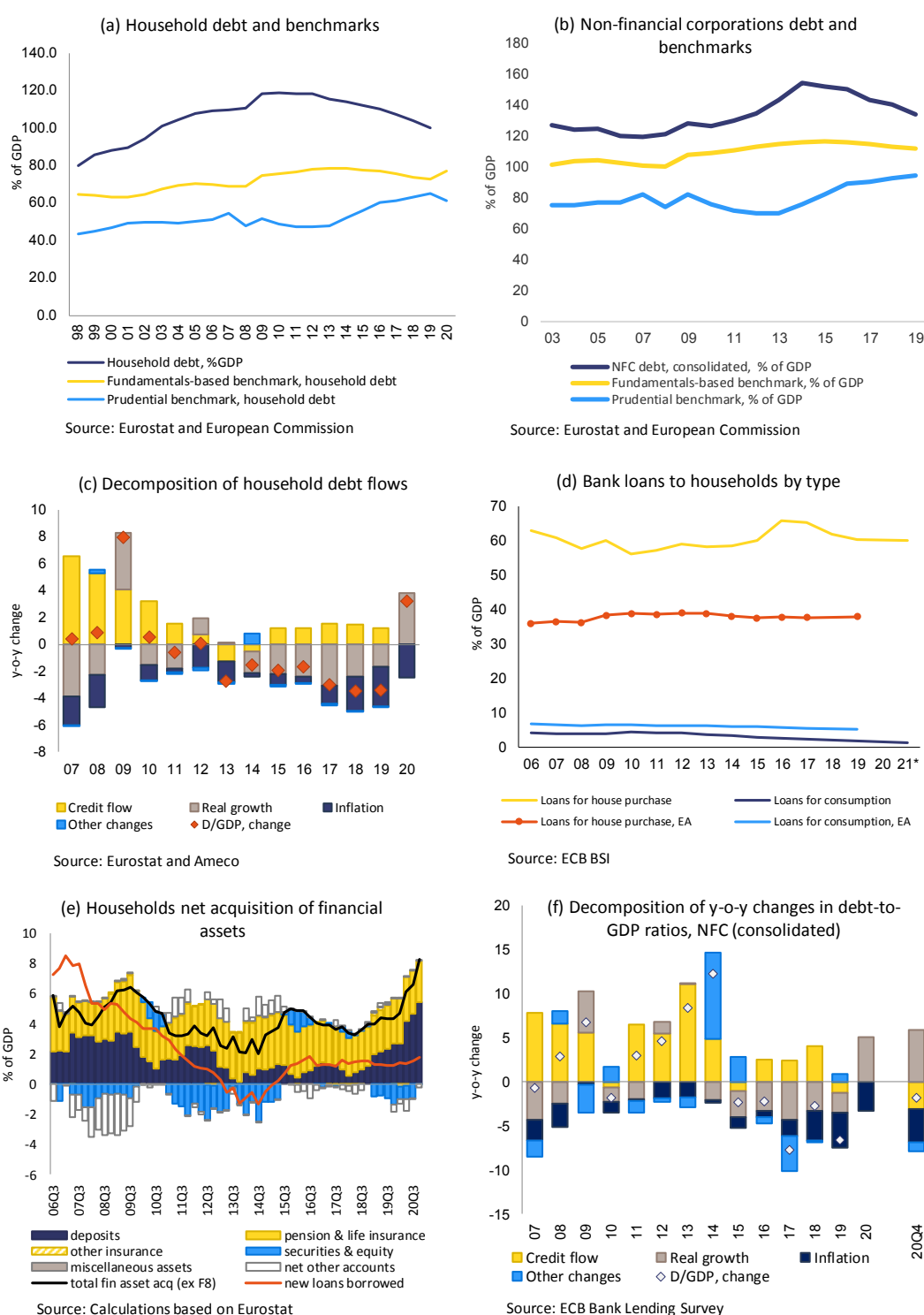
(2) Price to income and price to rent gaps are measured in deviation to the long term average (from 1995 to the latest available year).

(3) The model valuation gap is estimated in a cointegration framework with nominal house prices as the dependent variable and five fundamental explanatory variables: total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure. See Philipponnet and Turrini, Assessing House Price Developments in the EU (2017) available in "[https://ec.europa.eu/info/publications/economy-finance/assessing-house-price-developments-eu\\_en](https://ec.europa.eu/info/publications/economy-finance/assessing-house-price-developments-eu_en)" and revision notes presented to LIME in October 2019 and June 2020.

(4) The average house price gap is the simple average of the price-to-income, price-to-rent and model valuation gaps.

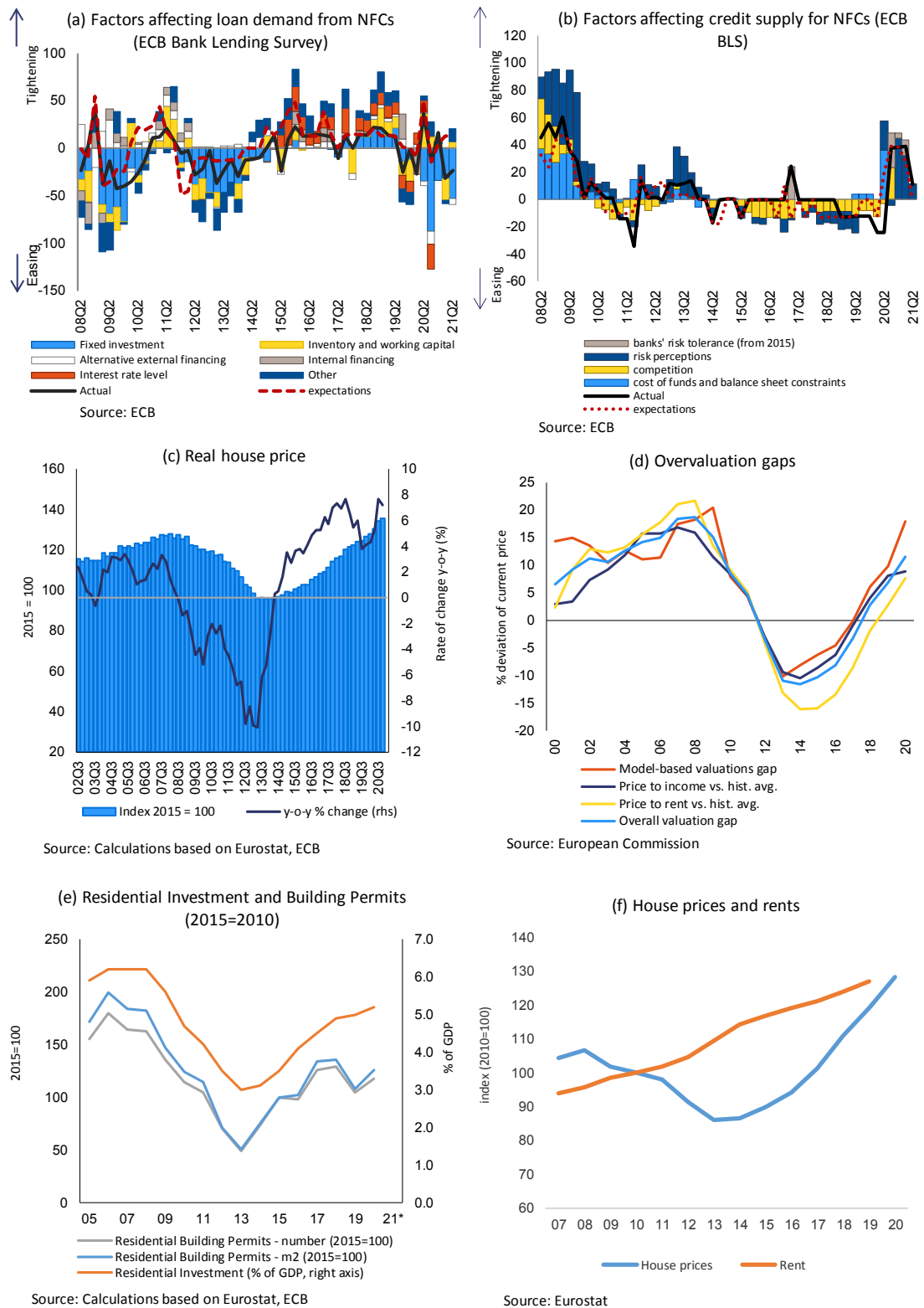
**Source:** Eurostat, OECD, ECB, BIS, Ameco, national sources, European Commission calculations.

Graph 3.1: Thematic Graphs: Private indebtedness and housing



Source: European Commission Services

Graph 3.2: Thematic Graphs: Private indebtedness and housing (cont.)



Source: European Commission Services