Kingdom of the Netherlands–The Netherlands: Staff Concluding Statement of the 2024 Article IV Mission

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February 9, 2024

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

February 9, 2024: *An International Monetary Fund (IMF) mission, led by Mr. Bernardin Akitoby, met with the Dutch authorities during a mission from January 29–February 9 to conduct the 2024 Article IV consultations. The following statement was issued at the end of the mission:*

While growth has slowed recently, the Dutch economy continues to show remarkable resilience. After 2 years of strong recovery, growth decelerated to about 0.1 percent in 2023, reflecting the energy shock, tighter financial conditions, and weaker external demand. Eroding consumer purchasing power dragged private consumption down in 2023 H1. Growth is estimated to have picked up in Q4 2023, with higher real wages and increasing house prices. Industrial production and exports remained sluggish, however, reflecting weak external demand; higher borrowing costs have weighed on investment. At 1.0 and 3.3 percent in December 2023, headline and core inflation declined significantly from their respective peaks in September 2022 and May 2023. The output gap is estimated to have declined from about 2 percent in 2022 to 0.4 percent in 2023, easing overheating pressures. However, the labor market has remained tight, including as firms have retained employees to ease hiring and dismissal and due to structural labor shortages. Unemployment remains historically low with the job vacancy rate among the highest in the euro area overall and in nearly all sectors, despite some easing in recent months. Nevertheless, the risk of a wage-price spiral appears contained, including as real wage levels remain below the pre-inflationary period. Despite measures to mitigate the impact of high energy prices, fiscal outcomes have strengthened, reflecting strong revenue collections and public investment underspending. The financial sector has so far been resilient, although risks are elevated.

Economic Outlook and Risks

Growth is expected to regain momentum in 2024 and 2025. Real GDP growth is projected to increase from 0.1 in 2023 to 0.6 and 1.3 percent in 2024 and 2025, respectively, largely driven by improved household purchasing power from lower inflation and stronger external demand. Higher interest rates will continue to weigh on business and residential investment. The output gap is expected to close in 2024, amid continuing signs of overheating, notably in the labor market. Growth in the medium term is projected to average around 1.6 percent, supported by public investment and reforms, including those outlined in the Recovery and Resilience Plan (RRP), although the impact of ageing will have offsetting effects.

Inflation is expected to continue to moderate. Headline inflation (annual average) is projected to decline from 4.1 percent in 2023 to 3.0 percent in 2024 and 2.3 percent in 2025. Meanwhile, core inflation is projected to slow from its peak of 7.4 percent in 2023, underpinned by the gradual easing of wage pressures and closure of the output gap. Broadly similar to the euro area average, headline and core inflation are expected to fall to the ECB inflation target in late 2025 and early 2026, respectively.

Risks are tilted downwards, amid heightened uncertainty. These include a potentially sharper slowdown in trading partner growth, rising geopolitical tensions, and deeper geo-economic fragmentation. Given that the Dutch economy has long benefited from substantial openness to achieve high living standards (2023 exports and imports of goods and services are estimated at about 85 and 74 percent of GDP, respectively), these risks could affect disproportionally a highly open economy like the Netherlands. A severe correction in the housing market could raise financial stability concerns through a real-financial feedback loop. Vulnerability to climate change also constitutes a risk, calling for continued enhancement of climate mitigation policies. Higher core inflation could become persistent if wage pressures lead to second-round effects. Over the medium term, insufficient progress on structural reforms to address labor supply shortages could weigh on potential growth and delay the green transition due to insufficient technical workers. All these factors call for retaining strong fiscal buffers, while strengthening the composition and execution of fiscal policy.

Fiscal Policy

The 2024 budget is moderately expansionary. The cyclically-adjusted fiscal deficit is projected to increase by 0.3 p.p. to 1.7 percent of GDP in 2024, mostly reflecting higher spending on social transfers, defense, and public investment. The budget includes a permanent social package amounting to 0.5 percent of GDP, with costs offset by raising taxes on higher-income individuals, to nonfinancial corporation and hiking the bank levy. The budget assumes that the energy support package is being phased out in 2024, except for a temporary emergency fund for higher energy costs, extended to mid-2024, and extension of reduced excise duties on petrol and diesel through end-2024 (0.1 percent of GDP). Social-support measures are generally well-targeted, but the extension of reduced excise duties is not—the phase-out this year is welcome. The increased employment tax credit for low-wage workers is well-targeted and focused on the supply side. Efforts on reducing implicit fuel subsidies are also ongoing and welcome.

In the near term, fiscal policy should balance support for inflation reduction with downside risks to growth. Given the higher cost of underestimating core inflation persistence, adopting a non-expansionary fiscal stance is warranted. Keeping the 2024 cyclically adjusted deficit broadly unchanged would require an adjustment of about 0.3 p.p. of GDP. While underspending and revenue overperformance may deliver, in the end, the desired stance, proactively identifying and implementing deficit-reducing measures would send a stronger signal. A good way to achieve this is through unwinding untargeted energy measures and rationalizing implicit fossil fuel subsidies.

Given high uncertainty, fiscal policy should be agile and flexible if risks materialize. Automatic stabilizers should provide a first line of response to adverse scenarios. A negative demand shock could call for a smaller fiscal adjustment compared to the baseline. A severe correction in the housing market could trigger a recession and necessitate discretionary fiscal support. However, a negative supply shock leading to stagflation, with higher and more-entrenched inflation, could call for a larger fiscal adjustment.

Given rising pressures from long-term fiscal challenges, adjustment will be needed to stabilize debt over the medium to long term and retain strong buffers. At 48.5 percent, the current public debt/GDP ratio is low, and debt is sustainable. However, significant spending pressures need to be addressed over the medium term. The authorities project that by 2028, spending on health care will increase from 9.5 to 10.5 percent of GDP; spending on old age pensions from 4.6 to 5.2 percent of GDP; and spending on defense from 1.4 to 2 percent of GDP. Moreover, age-sensitive pressures are expected to rise sharply in the long term. Other spending pressures arise from climate change and labor and housing shortages. Staff’s baseline projections show a continuous increase of the deficit and public debt over the medium term, in the absence of fiscal and structural reform measures. Staff support the authorities’ objective of stabilizing debt and estimate that the adjustment required to achieve this will be about 0.3 percentage points per year on average over 2024–28. This is broadly consistent with the recommendation of the 17th Budget Space Study Group report that called for an adjustment of €17 billion to stabilize the debt at its 2028 level, while keeping the deficit well below 3 percent of GDP. The objectives and path are also consistent with what is expected to emerge from final considerations on the revised EU fiscal framework. The required adjustment should be of high quality, not be achieved by lower overall investment spending, and protect or increase investment spending on key medium-term challenges—climate, labor markets, housing, and education. Structural factors behind investment underspending should be addressed to ensure timely implementation of investment plans, thereby reducing policy uncertainty.

The Netherlands enjoys low public debt, but medium-term challenges call for structural reforms to ensure fiscal sustainability. On pensions, linking the retirement age to greater life expectancy is an important instrument. On healthcare, consideration should be given to a combination of measures (efficiency gains, adjusting the basic policy package, or increasing co-payments) that could generate sufficient savings while mitigating risks and supporting solidarity. On climate, tilting the balance away from fossil fuel subsidies towards carbon pricing/taxes could help achieve climate goals efficiently, while supporting fiscal sustainability and allowing for more targeted social spending. Streamlining tax expenditures, particularly where inefficient and ineffective, would also help safeguard fiscal sustainability. Decisive action will be needed to implement reforms in these areas and to ensure policy continuity and predictability.

Financial Sector Policies

The IMF's Financial Sector Assessment Program (FSAP), conducted in 2023, found that the financial sector is generally resilient to adverse scenarios, though risks are elevated and warrant continued monitoring. The main risks stem from household and corporate debt, real estate, NBFIs, and climate change.

Household and corporate debt. The household debt burden has been declining since 2010, although debt levels and servicing remain high compared to peers. Considerable household assets provide a counterweight but are mainly held in pension savings. Corporate debt has declined (in percent of GDP), but debt-to-surplus ratios of firms are elevated relative to other EU countries.

Real estate. The financial sector is vulnerable to a steep contraction in real estate prices. Notwithstanding recent corrections, residential (RRE) and commercial real estate (CRE) valuations appear elevated. As a percentage of GDP, the exposure of Dutch banks to RRE and CRE collateralized loans are among the highest in the euro area. NBFIs, including insurers and investment funds, have expanded RRE lending. CRE investments are significant among insurers and occupational pension funds. A strong decline in RRE prices, particularly if coupled with a rise in unemployment, could increase mortgage defaults and losses. Risks are mitigated by a large share of fixed-rate mortgages, a falling prevalence of interest-only loans reflecting continued efforts to incentivize borrowers to lower their exposures to these loans, full legal recourse of lenders and strong debt-servicing commitment, a public mortgage-guarantee scheme, and some tightening of macroprudential policies by the authorities. Still, younger and lower income borrowers are more vulnerable to adverse financial shocks, while wealth effects from price declines could dampen growth and impact financial sector balance sheets. More broadly, housing affordability concerns call for increases in supply, which in turn will require supply-side measures, including greater efficiency and speed in the building process.

NBFIs. Occupational pension funds and insurers face market, liquidity, and inflation risks. Rising interest rates have increased concerns regarding potential margin calls on derivatives. However, the FSAP analysis shows the resilience of pension funds to liquidity risks in adverse scenarios. Pension funds' transition from the current defined benefit to a defined contribution system by 2028 is welcome as it improves their longer-term sustainability, but the transition also presents risks due to its complexity.For health and non-life insurers, claims inflation poses risks by straining profitability.

Climate. Sea-level rise and more frequent extreme rainfall heighten financial sector exposure to climate risk, although the FSAP found that so far banks and insurers are resilient to flood events. Likewise, some aspects of greening the economy, including nitrogen reductions, can pose risks for the affected industries and the financial sector, especially in the absence of full clarity on the transition path.

De Nederlandsche Bank (DNB) has appropriately strengthened macroprudential buffers. In May 2023, as systemic risks remained elevated while bank profitability was increasing, the countercyclical capital buffer was further raised by 1 percent to its 2 percent neutral level, effective this May. Other buffers for the largest banks were reduced by 0.25–0.75 CET1 percentage points to reflect European Banking Union progress and lower structural systemic risks. Minimum risk-weight floors for residential mortgages will remain in place at least until December 1, 2024.

While well-developed, the financial sector policy framework could be further strengthened. The FSAP mission identified key reform areas:

Macroprudential policy. Calibration of borrower-based measures should be focused on minimizing financial stability risks (which can enhance consumer protection), with access to homeownership objective addressed by other policies. The LTV limit should be gradually reduced, and mortgage interest deductibility phased out, considering elevated housing prices. A clear legal basis for regular access to granular transaction/loan-level data, including on RRE and CRE loans, should be ensured for risk monitoring and analysis.

Supervision. The authorities should: (i) adapt supervisory approaches to reflect a rapidly-changing market environment and strive for consistent supervisory outcomes across sectors; (ii) review the legislative framework to ensure that supervisory authorities have sufficient budgetary autonomy, delegated powers, and intervention tools to address risks promptly and efficiently; (iii) further clarify in law the requirement of independent board members of supervised institutions, both banks and NBFIs; and (iv) monitor and proactively manage potential risks of the pension system transition.

Climate risk oversight. The authorities have been leaders in climate risk supervision and quantitative analysis of climate risks. They could further, and more systematically integrate climate risks in their supervision, backed by enhanced data, scenario analysis, and disclosures. They could also establish an interagency body—or further facilitate this in an existing platform—to discuss and coordinate policy actions on climate issues with implications for financial stability. As the climate transition path—including nitrogen—becomes clearer, they should assess policy impacts on the financial sector.

Crisis management and resolution framework. After progress with ensuring legal certainty of the resolution framework and deposit insurance access to back-up funding, the authorities should further ensure operational readiness of resolution plans; identify and operationalize national sources for provision of liquidity in resolution (e.g., emergency liquidity assistance); and develop and test a national financial crisis management plan.

Financial integrity. The authorities should carry out comprehensive analysis of risks from misuse of legal entities and conduit structures, and improve availability and accuracy of beneficial ownership information.

Climate Change Policies

The Netherlands' climate goals appear achievable, but uncertainty remains. Based on planned climate policies, the Environmental Assessment Agency (PBL) estimates that greenhouse gas emissions, including nitrous oxide, could be between 46–57 percent lower in 2030 than in 1990. To achieve the goal of at least 55 percent reduction in 2030 with enough certainty, the Netherlands aims at 60 percent greenhouse gas reduction in 2030. To achieve this, it is critical to use all fiscal instruments available, striking a robust balance among subsidies/fiscal support, carbon pricing, and standards/norms, while addressing distributional concerns and ensuring policy predictability. Implicit fossil fuel subsidies, recently estimated at 4–5 percent of GDP,should be streamlined and reduced. The mission welcomes steps taken in the 2024 budget to this end. The phasing out of the fossil fuel subsidies implemented as part of regional and international agreements should be coordinated at the supranational level. Efforts should also enhance effectiveness of carbon pricing/taxation, complementing it with fees and feebates on products and activities, allowing for more targeted measures to support low-income households. The mission welcomes progress on climate adaptation policies, including: (i) integrating adaptation into government long-term planning; (ii) prioritizing adaptations with large positive externalities (e.g., climate risk research, updating building codes, strengthening infrastructure, early warning systems); and (iii) removing barriers to private adaptation while addressing distributional concerns.

Energy Security

The authorities are implementing several measures to enhance energy security. A new floating LNG terminal at Eemshaven doubled gas import capacity. Two new nuclear plants are planned, and KCB's operating life was extended beyond 2033. The Netherlands and Germany are drilling for a new gas field in the North Sea, with gas production expected by end-2024. To support the clean energy transition, the authorities should address bottlenecks, evidenced by the recent congestion of the electricity grid, while also incentivizing energy saving.

Additional Structural Policies to Enhance Economic and Social Resilience

Progress in tackling labor-market duality could increase resilience and improve social protection of the self-employed (SE). To establish a more level playing-field between employees and SE, the authorities have introduced and accelerated a phase out of the SE tax deduction. Given the higher risk of poverty among SE , the mission welcomes the authorities' discussion of mandatory disability insurance and the possibility of collective bargaining to enhance social protection. Pension arrangements for SE are another area where attention is needed. The authorities also aim to clarify the definition and conditions for employment and to reduce work uncertainty by restricting zero-hour contracts. Discussions are also ongoing, and the authorities aim to improve employer flexibility in times of stress, e.g., by allowing firms more flexibility in reducing hours when a crisis or calamity occurs.

Labor and skill shortages have emerged as a constraint on investment budget implementation, thus weighing on growth prospects, housing supply, green transition, and digitalization. Labor and skill shortages (e.g., health care, social work, green technologies) are likely to become more severe with population ageing and climate change. New skills and jobs will need to be created and filled. Selected measures could include:

Addressing labor and skill shortages by incentivizing part-time workers to increase hours worked. With labor force participation among the highest in the euro area, including for women, there is limited remaining potential to stimulate the extensive margin (participation). Efforts should focus on the intensive margin (hours per employed worker). Access to child and elderly care should be improved in a fiscally sustainable manner. Over the medium term, the tax-benefit system should be streamlined to reduce complexity.

Promoting training and labor mobility towards priority sectors (green transition, digitalization, health). Efforts should focus on: (i) adjusting active labor market policies by reorienting training towards addressing skills shortages in priority sectors; and (ii) continue to enhance and target lifelong learning programs to improve productivity.

Considering measures to adopt technology (including AI) and optimize international labor. Technology, including robotics and automation, may boost productivity and help reduce vacancies. For migrants, recognition and validation of qualifications acquired abroad should be streamlined and accelerated for skills that are in shortage.

Digitalization

A renewed emphasis on digitalization would help reduce labor shortages and support productivity. The Netherlands ranks among the top-performers in Europe on internet access and digitalization. This high degree of digitalization served the country well during the COVID-19 crisis. However, shortages of IT professional were reported even before the pandemic, while SMEs need faster adoption of digital technologies. The mission welcomes progress on implementing the RRP, which identifies digitalization as a key priority. Efforts to support research and development (R&D), streamline regulation, and investment in education should continue to help revive business investment and enhance learning.

The mission thanks the authorities and other counterparts for the constructive policy dialogue and productive collaboration.

IMF Communications Department

MEDIA RELATIONS

PRESS OFFICER: Eva Graf

Phone: +1 202 623-7100**Email:** MEDIA@IMF.org

@IMFSpokesperson