Rating Report

Report Date:
11 August 2017

Previous Report:
17 February 2017

Kingdom of the Netherlands

Analysts

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Ratings

Issuer	Debt Rated	Rating	Trend
The Netherlands, Kingdom of	Long-Term Foreign Currency - Issuer Rating	AAA	Stable
The Netherlands, Kingdom of	Long-Term Local Currency - Issuer Rating	AAA	Stable
The Netherlands, Kingdom of	Short-Term Foreign Currency - Issuer Rating	R-1 (high)	Stable
The Netherlands, Kingdom of	Short-Term Local Currency - Issuer Rating	R-1 (high)	Stable

Rating Rationale

On 11 August 2017, DBRS Ratings Limited (DBRS) confirmed the Kingdom of the Netherlands' Long-Term Foreign and Local Currency – Issuer Ratings at AAA and its Short-Term Foreign and Local Currency – Issuer Ratings at R-1 (high). The trend on all ratings remains Stable.

The AAA ratings are underpinned by the Netherlands' highly productive and diversified economy, robust fiscal framework, and strong external accounts. However, the economy faces both external and internal challenges, given its openness to trade, highly leveraged households, and labour market segmentation concerns. The Stable trends reflect DBRS's view that the economy is steadily expanding and that public finances are in a sustainable position. Although a new government has not yet been formed, the absence of urgent vulnerabilities to be addressed in the short term, together with stable institutions, mitigate the associated uncertainty. The output gap is gradually narrowing and is expected to close by 2019 on the back of a broad-based expansion. For the first time since 2008, the general government recorded a budget surplus in 2016. The debt-to-GDP ratio is on a downward trajectory, while bank-related contingent liabilities to the government have steadily declined. In the unlikely event that a severe deterioration in growth prospects occurs or a major deviation in the fiscal outlook takes place, the trend could be changed to Negative.

(Continued on page 2.)

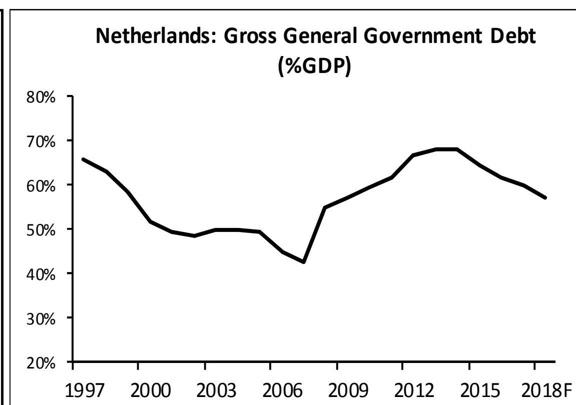
Rating Considerations

Strengths
(1) Wealthy and diversified economy
(2) Robust fiscal framework
(3) Strong external accounts

Challenges
(1) Exposure to external shocks
(2) Highly leveraged households
(3) Labour market segmentation

Summary Statistics

For the year ended December 31	2015	2016	2017E	2018F
Nominal GDP (EUR billions)	683.5	702.4	718.4	740.5
GDP per capita (EUR)	39,956	40,941	41,923	42,986
Real GDP (%chg)	2.3%	2.1%	2.4%	2.0%
Unemployment rate (year end, %)	6.9%	6.0%	4.9%	4.7%
Inflation (year end, %)	0.2%	0.1%	1.4%	1.4%
Current account balance (%GDP)	8.6%	8.5%	9.2%	9.1%
External debt (%GDP)	540.0%	532.8%	n.a.	n.a.
General gov't balance (%GDP)	-2.1%	0.4%	0.5%	0.7%
Primary balance (%GDP)	-0.8%	1.5%	1.5%	1.7%
Gross Public Debt (%GDP)	64.5%	61.8%	58.5%	55.4%
Human Development Index	0.92	n.a.	n.a.	n.a.



Sources: Centraal Bureau voor de Statistiek (CBS), De Nederlandsche Bank (DNB), Centraal Planbureau (CPB), European Commission (EC), International Monetary Fund (IMF), United Nations Development Programme, Haver Analytics, and DBRS.

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Rating Rationale (Continued from page 1)

The Netherlands' developed and diversified economy is a key strength. Dutch GDP per capita is well above the European Union (EU) average (+42%), reflecting the country's overall level of productivity and high levels of employment (75.1%, age group 20-64). Following a period of protracted weakness, GDP expanded at an average rate of 2% in the past three years, supported mainly by domestic demand. A positive feedback loop generated between rising house prices, a stronger labour market and higher confidence levels have uplifted investment and consumption. Looking ahead, the Dutch economy is expected to continue its solid growth pace.

The Netherlands' credible fiscal framework underpins the government's sound fiscal management and supports the ratings. The implementation of the fiscal compact reinforces the country's various fiscal supervision mechanisms. In the context of this framework, the government implemented a significant budgetary adjustment worth 6.7% of GDP between 2011 and 2016. This has helped put debt ratios on a firm downward trajectory over the near to medium term. Furthermore, the Netherlands changed the minimum retirement age, adjusted pension entitlements, and restrained healthcare spending, all of which have significantly improved the long-term sustainability of public finances.

The Netherlands' strong external accounts support the ratings. The country has historically benefited from a very robust exporting sector. Its role as a main European trade hub has been key in shaping its economic structure as an export-oriented economy. The strong trade performance has helped keep the Dutch current account in surplus since 1981. The current account surplus reached an estimated 8.5% of GDP in 2016. This is also reflected in the Netherlands' strong net creditor position, with the net international investment asset position reaching 69% of GDP in 2016. A strong external position provides the country with significant buffers to absorb external shocks.

Notwithstanding these underlying strengths, the Dutch economy is exposed to several external risks. The openness of the economy to trade is in many ways a strength, but in conjunction with the small size of the economy, suggests that external shocks could have significant adverse effects. The Netherlands is particularly exposed to worse-than-expected consequences from the United Kingdom's (UK) departure from the EU, given its strong trade linkages with the UK and the rest of the EU. The UK is the Netherlands' second-largest export destination in terms of value added. Similarly, an intensification of protectionist measures, hurting global growth and global trade, could have a disproportionate impact on the Dutch economy. Furthermore, a sharp slowdown in emerging markets or a re-emergence of the European crisis could pose headwinds to growth.

On the domestic side, high levels of household debt could pose risks to the economic outlook. Household debt, which stood at 242.3% of disposable income (Q1 2017), is high compared with other advanced economies. The portion of mortgage loans with high loan-to-value and loan-to-income ratios also remain significant, which could translate into higher credit losses. Other vulnerabilities include the still high stock of interest-only mortgages and the share of mortgages with negative equity. Despite these vulnerabilities, credit losses have been moderate throughout the economic downturn and remain low, with non-performing loans at 2.4% in Q1 2017. On the other hand, a prolonged period of household deleveraging could weigh on growth. Furthermore, highly leveraged households could exacerbate the economic fluctuations. In response to a negative shock, households may cut spending heavily and amplify the economic downturn. Households are more exposed to income and housing-price shocks than interest rate shocks, as mortgage holders predominantly have fixed-rate mortgages.

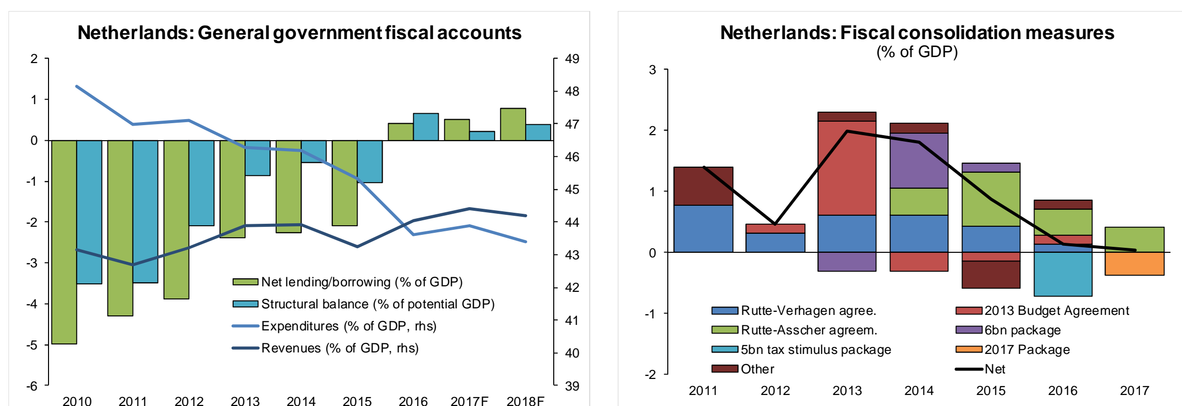
While strengthening economic conditions have been accompanied by improvements in the labour market, the increasing share of flexible employment raises concerns over labour market segmentation. This may discourage the incentive to invest in human capital and on-the-job training, and thereby lower labour productivity growth in the medium term. Moreover, the presence of institutional differences in employment protection between permanent and fixed-term contracts could hamper labour market transitions. Finally, a rising share of flexible and self-employed workers could affect the financial support base of social security schemes.

Foreign Versus Local Currency Ratings

DBRS maintains its foreign and local currency ratings at the same level because the Netherlands' access to external capital markets is commensurate with its access to domestic markets. The Dutch government predominantly issues in euros, with redemptions in foreign currencies estimated at EUR 3.1 billion between 2017 and 2030, at end-December 2016.

Fiscal Management and Policy

The government follows a rules-based fiscal policy with expenditure and revenue ceilings aimed at controlling spending and automatically stabilising revenues. With the implementation of the fiscal compact, the Centraal Planbureau (CPB) has the role of independent economic forecaster, while the Netherlands' Council of State (Raad van State) serves as the fiscal council, reinforcing the checks and balances present in the country's various fiscal supervision mechanisms.



Sources: CPB, CBS, Dutch Ministry of Finance (Ministerie van Financiën), EC, Haver Analytics, and DBRS.

The fiscal accounts have improved steadily since 2012 on the back of significant consolidation measures, lower interest costs and, from 2014, strengthening economic growth. In the wake of the 2008 financial crisis and subsequent euro-area crisis, the Netherlands ran deficits averaging 5.2% of GDP over the 2009 to 2010 period. In response, the government implemented fiscal consolidation measures worth 6.7% of GDP between 2011 and 2016. Moreover, the cyclical upturn boosted tax revenues, employment growth lowered expenditures on unemployment benefits, and lower interest rates reduced the interest bill. Moreover, the reforms undertaken to control ageing-related and health-care costs have significantly improved the long-term sustainability of government finances. The government made changes to the minimum retirement age and pension entitlements, and took steps to restrain healthcare spending, all of which have helped to mitigate ageing-related spending pressures. The next government is expected to progress with the pension system overhaul to be introduced by 2020.

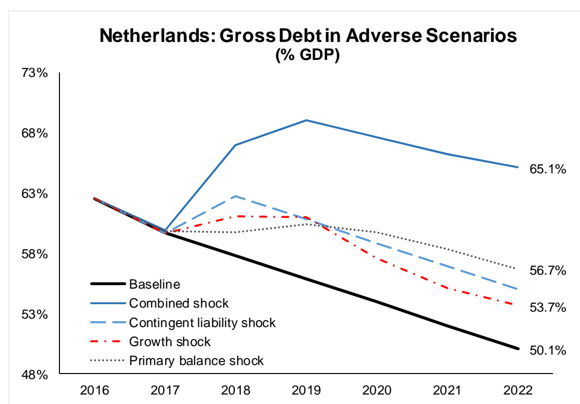
Last year, the budget balance was positive for the first time since 2008. On the back of stronger than expected revenues and improving macroeconomic conditions, the government registered a headline and structural fiscal surplus of 0.4% and 0.5%, respectively. Looking ahead, the CPB estimates a further improvement of the budget surplus to 0.5% and 0.7% of GDP in 2017 and 2018, respectively. However, these budgetary projections, which assume no policy change, could be revised once the new government is formed. DBRS expects the fiscal targets to be slightly lower than the government's previous projection, which showed a budget surplus of 1.3% of GDP in 2021. While the new government may use some of the existing fiscal room to increase spending and/or lower the tax burden, DBRS does not foresee a material deviation from the baseline. With respect to the 2018 Draft Budget, which has to be presented on 19 September 2017, no major policy changes are expected.

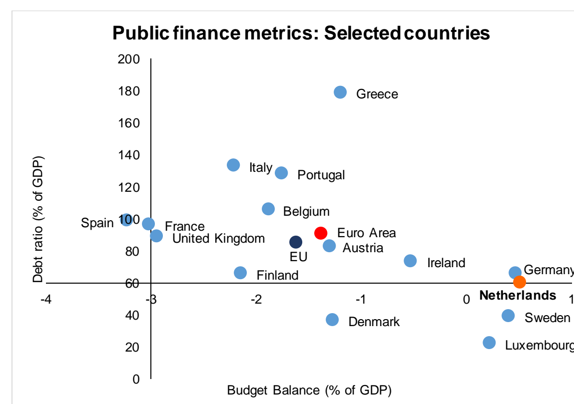
Debt and Liquidity

General government debt-to-GDP ratio is at a moderate level and steadily declining. The debt ratio peaked at 67.9% in 2014, well above the 42.7% recorded in 2007. The increase was primarily due to government interventions in the financial sector, contributions to the euro-area sovereign rescue packages, and the effect of automatic stabilisers on the deficit. In contrast, improving primary balances, nominal GDP growth, privatisation proceeds, and lower funding conditions have put the debt ratio on a firm downward trajectory.

In 2016, the debt ratio stood at 61.8% after dropping 2.7 percentage points relative to 2015. In particular, the further privatisation of ABN Amro and Propertize contributed to the ratio's decline. The downward trend in the debt ratio is expected to continue, with the CPB projecting the debt level to drop to 58.5% in 2017 and 55.4% of GDP in 2018. This is mainly explained by the primary surplus and the denominator effect. The interest bill will continue to benefit

somewhat from continued favourable funding conditions. While the new government could implement some budget-increasing measures, DBRS does not expect a significant deviation from current projections. It should be noted that the CPB's debt projections assume a continuation of the planned re-privatisation of financial institutions partially owned by the state. The Dutch state sold an additional 7% stake in ABN Amro, raising EUR 1.5 billion at the end of June 2017.





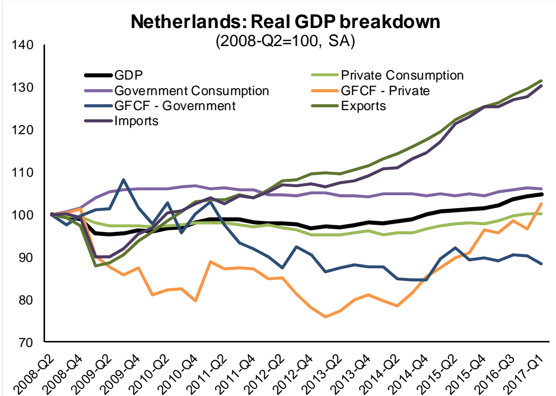
Note: For the purposes of the debt sustainability analysis, the baseline scenario is based on projections from the International Monetary Fund's (IMF) World Economic Outlook (April 2017). The growth shock assumes an average growth of 0.7 percentage points (pp) lower in 2018-2022. The primary balance shock assumes a fiscal slippage from the baseline on average of 1.1 pp. The contingent liability shock is assumed at 4.7% of GDP. Sources: Eurostat, DNB, Dutch Ministry of Finance, Dutch State Treasury Agency, EC, IMF, Haver Analytics, and DBRS.

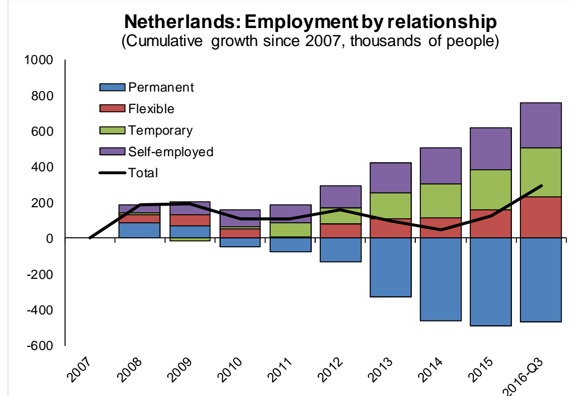
Debt dynamics have also benefitted from favourable funding conditions and debt structure. As of end-July 2017, yields on the ten-year government bond stood at 0.7%, well below the 2002-08 average of 4.1%, and its bonds up to five years enjoyed negative interest rates. A healthy debt structure shields the government from interest and exchange risks. Taking advantage of the low interest environment, the government has increased the average duration on its debt to 5.6 years in 2016 from 3.5 years in 2012, and plans to lengthen it further to 6.4 years by 2019. Debt is also predominantly denominated in euros. The debt structure and the projected debt reduction allow the government to absorb significant shocks without endangering its sustainability. According to DBRS's public debt sustainability analysis, the debt-to-GDP ratio would remain below the EU's 60% threshold by 2022 under a number of adverse shocks (growth, primary balance, interest rates, and contingent liabilities). Even under a combined shock scenario, which DBRS considers a very low probability event, the country's debt dynamics appear to be sustainable (65% of GDP by 2022).

Economic Structure and Performance

The country benefits from a competitive economy and a highly productive labour force. Following a period of protracted weakness, including a double-dip recession, the Dutch economy returned to growth in 2014 and recorded an average 2% GDP expansion between 2014 and 2016. Growth has been broad-based, mostly driven by domestic demand. A positive feedback loop generated between rising housing prices, a stronger labour market and higher confidence levels have uplifted investment and consumption. Investment staged an impressive comeback, especially in housing (20% growth on average in 2015 and 2016), after the collapse experienced between 2008 and 2013. Against this improved backdrop, consumption has been buoyed by rising disposable income and confidence effects. Measures adopted in recent years (such as the EUR 5 billion package) are still having an effect on consumption.

The economic upswing has been accompanied by a rising demand for labour and falling unemployment. Despite improving labour market conditions, the increasing share of flexible employment raises concerns over labour market segmentation. Highly protective employment legislation, rigid social benefit requirements for permanent contracts, and broad exemptions for the self-employed could be behind these trends. While the existence of flexible employment potentially increases the economy's responsiveness to shocks, a high share of flexible employment may lead to labour segmentation. Moreover, the low transitional rate to permanent from transitory positions in the Netherlands signals that this segmentation could be durable. This may diminish the incentive to invest in human capital and on-the-job training, and thereby lower labour productivity growth in the medium term. Finally, a rising share of flexible workers and self-employed could affect the financial support base of social security schemes.





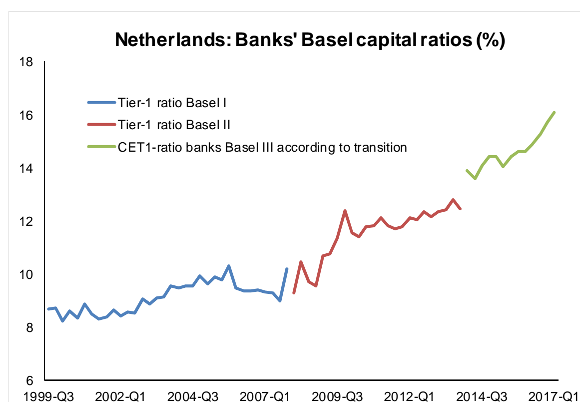
Sources: DNB, CBS, Haver Analytics, and DBRS.

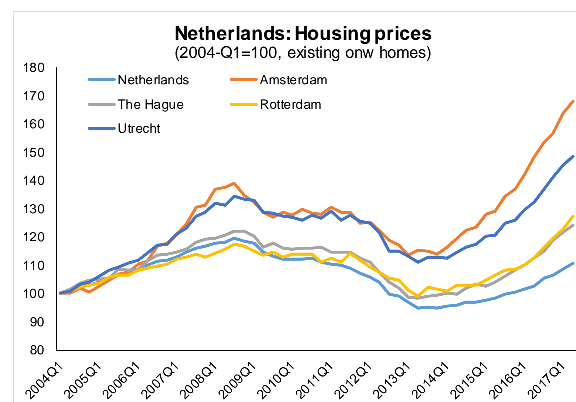
Going forward, the Dutch economy is expected to continue its solid growth pace. GDP growth is forecast to peak at 2.4% in 2017, fuelled by an upswing in global trade and a pickup in corporate investment. A slight deceleration is expected to ensue in 2018 (2.0%) and 2019 (1.9%) as the global trade expansion loses momentum and housing investment returns to more normal rates of expansion. However, the economic outlook is subject to uncertainty. Given the open nature of the Dutch economy, the main downside risks to the economy stem from the external environment. The Netherlands is particularly exposed to worse than expected consequences from the UK's departure from the EU, given its openness and trade linkages with the UK. Similarly, an intensification of protectionist measures, hurting global growth and global trade, could have a disproportionate impact on the Dutch economy. Furthermore, a sharp slowdown in emerging markets or a re-emergence of the European crisis could pose headwinds to growth.

Monetary Policy and Financial Stability

The high level of household debt is a source of concern. Household debt, most of which is concentrated in mortgage loans, stood at 242.3% of disposable income (Q1 2017) and is one of the highest in the world. Around 20% of the mortgages are in negative equity, albeit the share is declining because of the housing market recovery. Although credit losses are small in banks' lending portfolio, with non-performing loans at 2.4% in Q1 2017, households may cut spending heavily in response to a negative shock, and amplify an economic downturn. The portion of mortgage loans with high loan-to-value (LTV) and loan-to-income ratios also remain significant, which could translate into higher credit losses in the case of default. The relatively high share of interest-only mortgages (55% of the total stock) is another focus of vulnerability. The bulk of these mortgages will mature from 2030 onwards. On the other hand, the overall net wealth of households could act as a buffer against potential shocks. Nonetheless, a material share of household assets is illiquid and net wealth is unevenly distributed across different age cohorts.

Since bottoming out in 2014, house prices and transaction volumes have been steadily accelerating. While real house prices are broadly consistent with fundamentals at the aggregate level, developments have been uneven across regions and may warrant monitoring.





Sources: DNB, CBS, Haver Analytics, and DBRS.

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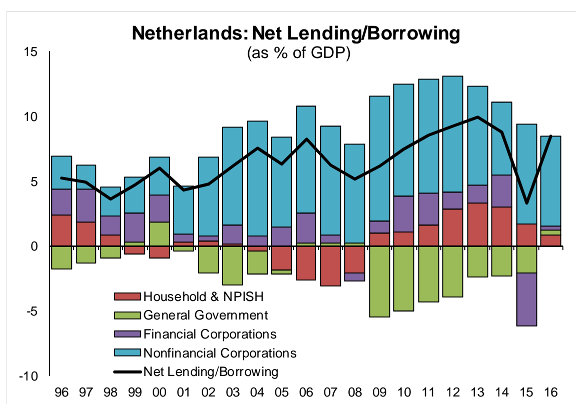
The Dutch banking system is large and concentrated. Banks' assets relative to GDP stood at 371.4% in Q1 2017, with the five largest banks accounting for 84.8% of the total assets. Since the 2008 financial crisis, the overall strength of the Dutch banks has improved significantly. The government capital support to financial institutions (ING and AEFON) during the financial crisis has been repaid in full, the guarantee scheme for medium-term bank debt was wound down, and nationalised financial institutions have been or are in the process of re-privatisation. Dutch banks are relatively well capitalised, as shown by the core capital ratio of 16.1% in Q1 2017, although still show high leverage ratios.

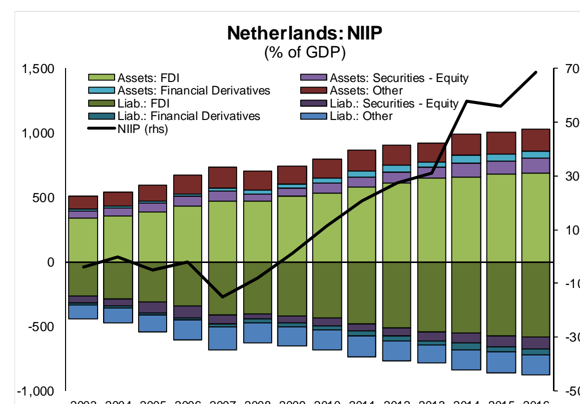
A protracted period of low interest rates and banks' dependence on wholesale funding could pose challenges to the sector. A prolonged period of low interest rates could significantly erode banks' earnings, especially in light of Dutch banks' strong dependence on net interest income. Profitability has, however, remained resilient in recent years. Dutch banks' reliance on capital markets to plug the deposit-funding gap remains high, albeit to a lesser degree than pre-crisis levels. The volume of short-term funding has also dropped from pre-crisis levels to around 28% of total market funding raised, further reducing banks' vulnerability. The banks are globally interconnected, and therefore, susceptible to cross-border shocks.

Overall, financial stability risks appear contained. The IMF's solvency and liquidity stress tests show that the Dutch banking system is resilient to adverse shocks and is able to withstand significant funding withdrawals, with limited risk of contagion among banks. Financial fragilities have declined in recent years, as the government has taken actions to reduce financial risks and partially reverse the tax incentives to debt financing. In light of the current housing market recovery and still-high level of household indebtedness, the IMF has recommended that the government step up its efforts by: (1) accelerating the phase-out of mortgage interest deduction; (2) continuing with the reduction of the maximum LTV to 90% by 2028; and (3) introducing a debt-service-to-income cap by income category.

Balance of Payments

The Netherlands has registered large and persistent current account surpluses, averaging 5.0% between 1981 and 2016. This trend has been essentially explained by the large goods trade surpluses, which averaged 10.3% of GDP between 2004 and 2016. The Netherlands' role as a major European trade hub, closely linked to its favourable geographical location and its large port of Rotterdam, contributes to its strong external accounts. More than half of the inbound goods are either transit trade or re-exports, with the latter accounting for roughly 45% of total goods exports. Chemicals, food and live animals, and inedible crude materials (except fuels) have been the main contributors to net exports. The decline in the country's gas exports (price and quantity reductions) has shrunk significantly the sector's contribution to net exports in recent years.





Sources: DNB, CBS, Organisation for Economic Co-operation and Development, Haver Analytics, and DBRS.

The current account patterns have mirrored structural factors including the relatively high savings and investments abroad by the non-financial corporate sector and pension funds. The large number of multinational enterprises (MNEs) headquartered in the Netherlands, which have retained significant earnings abroad (probably because of tax incentives), has played a key role in explaining the significant savings from the corporate sector. Pension funds, which hold the largest share of household savings, mainly invest overseas, increasing the surplus further. Cyclical factors have played a smaller role. The cyclical downturn in the aftermath of the crisis, housing market collapse,

and fiscal consolidation have dampened domestic demand and put upward pressure on the current account for some years. Over time, the current account is expected to gradually moderate as domestic demand strengthens and population ages.

The Netherlands' strong external position provides the country with significant buffers to absorb external shocks. The net international investment position (NIIP) has significantly improved since the financial crisis, with the Netherlands' NIIP increasing to an estimated asset position of 69% of GDP 2016 from a liabilities position of 15% of GDP in 2007. Nonetheless, the large asset position is exposed to valuation risks (i.e., fluctuations in asset prices and/or exchange rate risk).

Political Environment

Last election: 15 March 2017
Next election: Not yet determined
Coalition in power: Centre-right People's Party for Freedom and Democracy (Volkspartij voor Vrijheid en Democratie; VVD) and centre-left Labour Party (Partij van de Arbeid; PvdA), until the next government is formed.
Government structure: Parliamentary democracy
Acting Prime Minister: Mark Rutte

The Netherlands benefits from strong democratic traditions, effective public institutions, checks and balances, and low levels of corruption. The Netherlands has a multi-party system, with a large number of parties representing diverse minority interests. Since World War II, no single party has managed to win an absolute majority, and consequently coalition governments have been the norm.

The Lower House election held on 15 March 2017 delivered an even more fragmented political landscape. The centre-right VVD (21.3%) won the most votes, followed by the eurosceptic Party for Freedom (PVV, 13.1%), Christian Democratic Appeal (CDA, 12.4%), and Democrats 66 (D66, 12.2%). The remaining nine parties that won seats in the House of Representatives obtained less than 10% of the votes each. Despite the fact that the PVV gained additional seats in the Lower House, concerns associated with its rise have ameliorated considerably since the election. The PVV, which had been leading the polls for several months ahead of the election, trailed significantly behind the VVD in the final vote. Furthermore, the wave of euroscepticism appears to have lost momentum.

As a new government has not yet been formed, the "grand coalition" (VVD and PvdA) is acting as a caretaker government. The caretaker government may deal only with ongoing matters and cannot initiate new policy. Forming a new coalition government has proven difficult so far. Given the fragmented Dutch political landscape, a majority government (with 76 seats or more in the lower house) would need to be composed of at least four parties. A detailed programme is traditionally agreed on between the parties before a new coalition is sworn in, usually making the process lengthier than in other countries.

Currently, *informateur* Gerrit Zalm is overseeing the coalition negotiations between the VVD, CDA, D66, and the CU. According to Dutch media, the negotiating parties are close to an agreement on fiscal policy but still have some differences on migration, climate policy, and euthanasia. A potential final agreement could be reached in coming weeks. Although this coalition would have a slim majority in the Lower House (76 seats), other parties could help the future government to pass laws. No details are available over the specifics of the negotiations, but DBRS does not expect significant deviations from the current policy mix. If coalition talks were to fail, a minority government (VVD, CDA, and D66) would look increasingly likely. The probability of a new election or the PVV forming part of the new government currently remain small.

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Netherlands: Selected Indicators

For the year ended December 31

(EUR billions unless otherwise noted)	2011	2012	2013	2014	2015	2016
Public Sector Debt						
General Government Gross Debt	396.3	428.3	442.2	450.5	441.0	434.1
% GDP	61.7%	66.4%	67.7%	67.9%	64.5%	61.8%
General Government Net Debt	381.9	413.3	430.7	440.1	431.3	423.6
% GDP	59.4%	64.1%	66.0%	66.4%	63.1%	60.3%
Domestic Debt						
General Government	165.7	188.5	191.7	178.5	183.6	208.5
% GDP	25.8%	29.2%	29.4%	26.9%	26.9%	29.7%
External Debt						
General Government	230.6	239.8	250.5	272.0	257.4	225.6
% GDP	35.9%	37.2%	38.4%	41.0%	37.7%	32.1%
Private Sector	3,069	3,114	3,108	3,298	3,433	3,517
% GDP	477.4%	482.8%	476.0%	497.3%	502.3%	500.7%
Gross External	3,299	3,354	3,358	3,570	3,691	3,743
% GDP	513.3%	520.0%	514.4%	538.3%	540.0%	532.8%
Private Sector Debt						
Households	824.1	827.8	817.2	822.6	834.6	841.8
% GDP	128.2%	128.3%	125.2%	124.1%	122.1%	119.8%
Non-Financial Firms	796.5	788.3	789.2	807.8	859.0	864.5
%GDP	123.9%	122.2%	120.9%	121.8%	125.7%	123.1%
Fiscal Balances (% GDP)						
Revenues	42.7%	43.2%	43.9%	43.9%	42.8%	43.7%
Expenditures	47.0%	47.1%	46.3%	46.2%	44.9%	43.3%
Interest Payments	1.8%	1.6%	1.5%	1.4%	1.2%	1.1%
General Government Balance	-4.3%	-3.9%	-2.4%	-2.3%	-2.1%	0.4%
Interest Payments (% Revenues)	4.1%	3.8%	3.5%	3.2%	2.9%	2.5%
Primary Balance	-2.5%	-2.2%	-0.9%	-0.8%	-0.8%	1.5%
Balance of Payments & Liquidity						
Current Account Balance	55.9	66.8	64.4	58.9	58.7	59.6
% GDP	8.7%	10.4%	9.9%	8.9%	8.6%	8.5%
Trade Balance (% GDP)	10.1%	11.0%	11.5%	11.4%	11.5%	11.9%
Foreign Direct Investment (% GDP)	4.3%	0.6%	10.1%	-5.0%	8.5%	10.5%
International Investment Position	132.3	175.9	202.6	383.5	383.1	482.7
% GDP	20.6%	27.3%	31.0%	57.8%	56.0%	68.7%
External Assets	6,215	6,568	6,711	7,378	7,692	8,077
External Liabilities	6,083	6,392	6,508	6,994	7,309	7,594

Note: General government net debt includes currency and deposits of the general government; private sector debt includes loans and securities other than shares of households, non-profit institutions serving households and non-financial corporations.
Sources: Government of the Netherlands, DNB, CBS, Eurostat, European Central Bank, IMF, EC, Haver Analytics and DBRS.

Ratings History

Issuer	Debt Rated	Current	2016	2015	2014
The Netherlands, Kingdom of	Long-Term Foreign Currency - Issuer Rating	AAA	AAA	AAA	AAA
The Netherlands, Kingdom of	Long-Term Local Currency - Issuer Rating	AAA	AAA	AAA	AAA
The Netherlands, Kingdom of	Short-Term Foreign Currency - Issuer Rating	R-1 (high)	R-1 (high)	R-1 (high)	R-1 (high)
The Netherlands, Kingdom of	Short-Term Local Currency - Issuer Rating	R-1 (high)	R-1 (high)	R-1 (high)	R-1 (high)

Note:
All figures are in euros unless otherwise noted.

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