Netherlands
Rating Report

STABLE OUTLOOK
AAA

Credit strengths

- Wealthy, diversified and internationally competitive economy
- Moderate public debt
- Strong external position
- Resilient banking system

Credit challenges

- Increase in government debt
- High private-sector indebtedness
- Sensitivity to global developments
- Labour market duality, with a high share of part-time employment

Rating rationale:

Wealthy and competitive economy: The Netherlands' rating is supported by its wealthy, highly diversified and competitive economy. Output has reached its pre-pandemic level by the third quarter of 2021, and we expect more limited longer-run scarring from this Covid-19 crisis. Moderate medium-run growth potential of 1.4% remains in line with that of similarly rated sovereign peers.

Moderate public debt: The general government debt-to-GDP ratio is expected to increase in 2021 to around 59.2% and edge thereafter along a comparatively flat trajectory, ending a forecast horizon at 58.6% in 2026, remaining more than 10pps above Netherlands' debt ratio immediately from before the crisis. However, Scope considers the Dutch government to retain significant fiscal flexibility.

Strong external sector: The country's external resilience is underpinned by high and recurrent current account surpluses and a strong net international investment position (NIIP).

Resilient banking system: The Dutch banking system has proven resilient to the crisis. Capitalisation, asset quality and profitability are sound and broadly in line with that in peer economies.

Rating challenges include: i) labour market dualities; ii) sensitivity of the economy to global developments as a highly open economy; iii) financial stability risk with high and rising housing prices and high private-sector debt; and iv) the increase of government debt since the crisis.

Netherland's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	aaa		0	
Public Finance Risk		25%	aa+		+1/3	
External Economic Risk		10%	aaa		0	
Financial Stability Risk		10%	aaa		-1/3	AAA
ESG Risk	Environmental Risk	5%	bbb		0	
	Social Risk	5%	a-		0	
	Governance Risk	10%	aaa		0	
Overall outcome		**aaa**		**+1**	**0**	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings GmbH.

Outlook and rating triggers

The Stable Outlook reflects Scope's view that a change of the ratings is currently not expected over the next 12 to 18 months.

Positive rating-change drivers

- N/A

Negative rating-change drivers

- A global or regional shock resulted in a significant drop of output and/or accentuated risk to financial stability
- The fiscal outlook deteriorates significantly, including elevated fiscal deficits and increasing debt levels through the cycle

Ratings and Outlook

Local and foreign currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

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Bloomberg: RESP SCOP

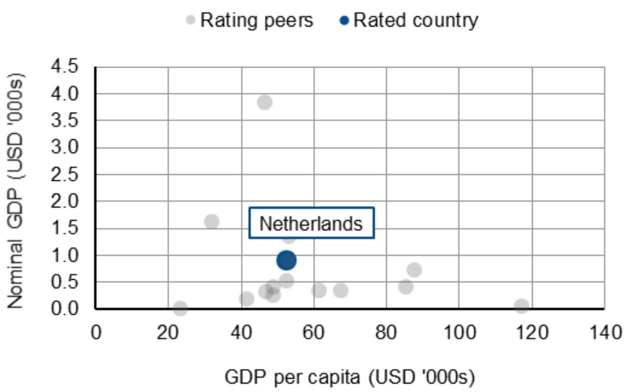
Domestic Economic Risks

- **Growth outlook:** The Netherlands' rating is supported by a wealthy, highly diversified and competitive economy. In 2020, the pandemic resulted in a drop in real GDP of 3.8%, which compares favourably to that of the euro-area average of 6.5%. Nominal output has reached its pre-pandemic level by the third quarter of this year, and we expect full-year growth of 4.4%, with, thereafter, 3.1% in 2022 and 2.3% in 2023. Due to budget support, a high share of employment adaptable to telework and the high competitiveness of the Dutch economy, we expect more limited longer-run economic scarring from the Covid-19 crisis. This keeps our medium-term expectation of potential GDP growth intact around 1.4%, in line with that of Netherlands' sovereign peer group. The longer-run growth outlook is abetted, furthermore, by an expansionary fiscal position as well as EUR 6bn of grant allocations (0.6% of average 2021-26 GDP) via the EU Recovery and Resilience Facility and associated reform and investment priorities. In September 2020, the "National Growth Fund" was initiated, with plans of increasing public investment in the amount of EUR 20bn (2.5% of GDP) over the next five years.
- **Inflation and monetary policy:** Headline inflation stood at an elevated 5.2% YoY in November 2021 and averaged 2.4% YoY over the first 11 months of 2021, against 1.3%, on average, over the first 11 months of 2020. This rise of inflation, especially over the second half of 2021, has been mostly driven by increasing energy and gas prices with core inflation more moderate. The ECB has maintained accommodative monetary policies over the Covid-19 crisis.
- **Labour market:** The Dutch labour market has recovered strongly from the crisis. The unemployment rate has declined to 2.7% in November 2021, from a peak of 4.6% in August 2020, and is currently under pre-crisis levels. This relative resilience can be explained by the high share of persons employed in services industries with higher adaptability to telework. Labour market rigidities persist, as businesses cite a lack of labour supply as a key bottleneck affecting production. Furthermore, the share of part-time employment remains high, particularly among women.

Overview of Scope's qualitative assessments for the Netherlands' *Domestic Economic Risks*

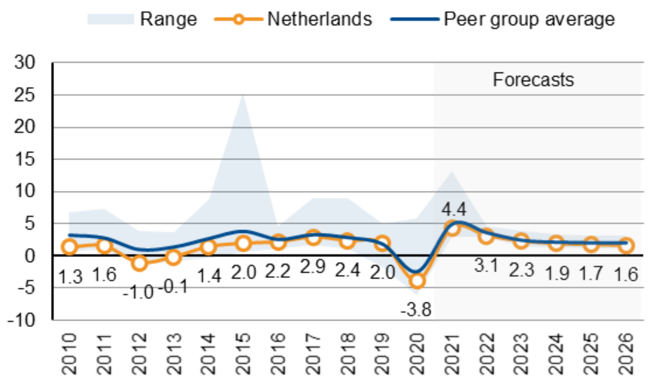
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank
	Macro-economic stability and sustainability	Neutral	0	Competitive and diversified economy; flexible labour market although dualities exist

Nominal GDP and GDP per capita, USD thousands



Source: IMF, Scope Ratings GmbH

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

Public Finance Risks

- **Fiscal outlook:** The Netherlands' ratings are anchored by a robust budgetary framework and still moderate levels of public debt. Before this crisis, the budget balance averaged a surplus of 1.3% of GDP over 2016-2019, resulting in the debt-to-GDP ratio declining to 47.4% by end-2019 (from 68% as of end-2014).

  The government response to the crisis brought sizeable budget deficits of 4.3% of GDP in 2020 and an estimated 5.9% of GDP in 2021. After agreement around a fourth Mark Rutte government, expansive economic priorities include the combatting of climate change, protecting the environment and enhancing sustainable energy, speeding up construction of housing, enhancing education and labour market participation, extending free childcare, tax breaks for the middle income alongside a 7.5% increase of the minimum wage, representing a significant break from a more austere past. Scope anticipates budget deficits to moderate, nevertheless, to 2.8% of GDP in 2022, mainly from a gradual phasing out of support measures linked to the crisis as well as higher tax revenue aligned with rebound in the economy. Medium run, a continuation of more elevated deficits is assumed, with the budget deficit averaging 2.4% of GDP over 2023-2026.

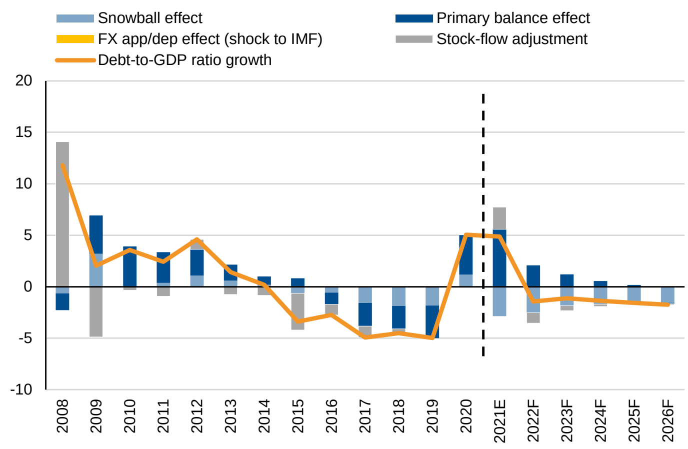
- **Debt trajectory:** The general government debt-to-GDP ratio is expected to increase in 2021 to around 59.2% and edge thereafter along a comparatively flat trajectory, ending a forecast horizon at 58.6% in 2026, remaining more than 10pps above Netherlands' debt ratio immediately before the crisis. Netherlands' debt ratio of 54.2% of GDP as of the end of the second quarter of 2021 was, however, approximately in line with that of an average for AAA-rated sovereign borrowers. We consider the Dutch government to retain significant fiscal flexibility.

- **Market access:** The Dutch State Treasury Agency enjoys excellent market access. The Netherlands' benchmark 10-year yield stood at -0.2% at time of writing. Dutch state loans carry a long weighted average remaining life of 8.8 years, and the government issues only in euro.

Overview of Scope's qualitative assessments for the Netherlands' *Public Finance Risks*

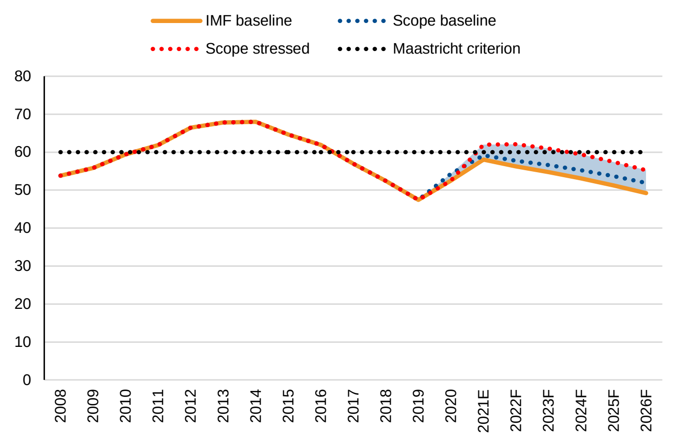
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Fiscal policy framework	Neutral	0	Strong national fiscal framework, in line with peers; pre-crisis budgetary surpluses; wider fiscal deficits under new government
	Debt sustainability	Strong	+1/3	Moderate public debt ratio including resilience of debt sustainability under adverse scenarios
	Debt profile and market access	Neutral	0	Excellent government market access, low government financing costs, in line with peers

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings GmbH

External Economic Risks

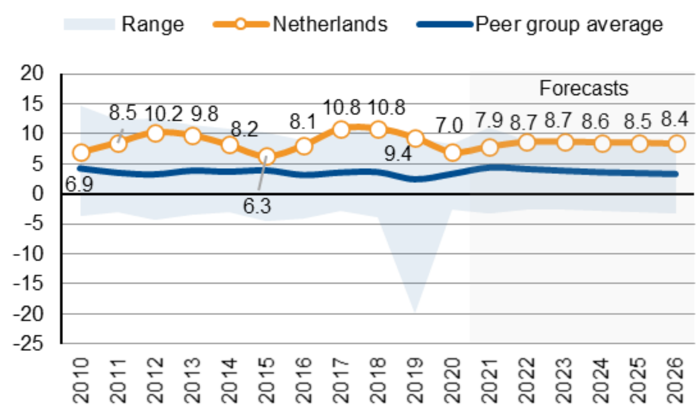
- **Current account:** Netherlands' ratings benefit from elevated and recurrent current account surpluses, averaging 9.1% of GDP over 2015-19 pre-crisis before moderation to 7% of GDP in 2020 as worsening income balances offset improvement in the trade surplus. Over the year to Q2 2021, the current account surplus had re-widened to 8.9% of GDP. Netherlands' share of global exports rose temporarily to 3.2% in 2020, returning to levels last observed in 2010.
- **External position:** External resilience is bolstered by Netherlands' position as a strong international external creditor nation, with a net international investment position of 99.5% of GDP as of the end of June 2021 – improving from 56.3% in Q1 2017.

  External debt is high – amounting to 431.5% of GDP in Q2 2021, having nevertheless decreased substantively over the past five years. Most external debt is held by non-monetary financial institutions (185% of GDP at end-2020), trailed by monetary financial institutions (97%) and non-financial corporations (71%). 42% of external debt is short-term.
- **Resilience to shocks:** Euro area membership bolsters resilience to short-term shocks. The Netherlands, as a highly open economy, is integrated in global export markets, increasing sensitivity to global trade shocks. Exports of goods and services totalled around 82.5% of GDP in 2019, significantly above levels of peer economies.

Overview of Scope's qualitative assessments for the Netherlands' *External Economic Risks*

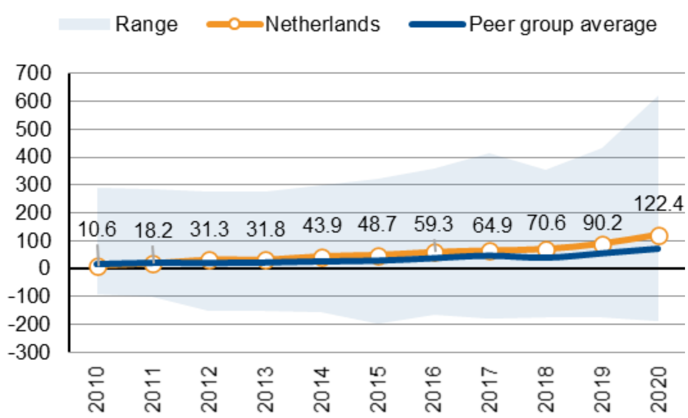
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Current account resilience	Neutral	0	Diversified and competitive exporting sector; recurrent and large current account surpluses also driven by high net savings of multinationals benefitting from favourable tax treatment
	External debt structure	Neutral	0	High external debt and elevated share of short-term external debt, mitigated partially by favourable composition including large intragroup borrowing plus a sizeable net external asset position
	Resilience to short-term external shocks	Neutral	0	Highly open economy; benefits from euro-area membership

Current account balance, % of GDP



Source: IMF, Scope Ratings GmbH

Net international investment position, % of GDP



Source: IMF, Scope Ratings GmbH

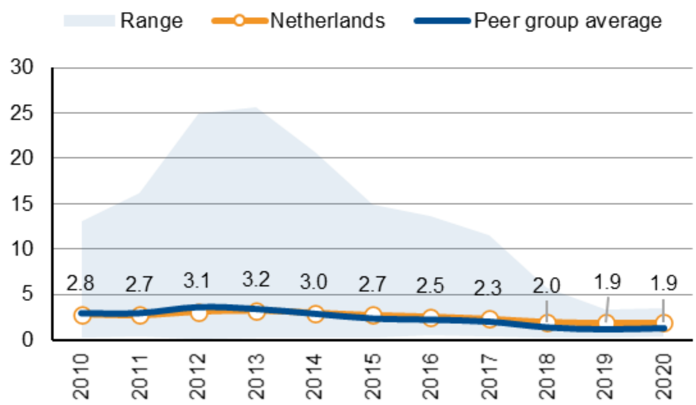
Financial Stability Risks

- **Banking sector:** The soundness of the Dutch banking system is a credit strength. Dutch banks' capital positions have not deteriorated since the pandemic, partly due to the non-performing loan (NPL) ratio having moderated a little to 1.6% of aggregate loans in Q2 2021, from 1.9% in end-2019. However, withdrawal of government support may raise the probability of default or write-downs of bank loans. System-wide tier 1 capital ratios amounted to 19.4% of risk-weighted assets as of Q2 2021, slightly above pre-crisis levels of 18.9% as of Q4 2019. The resilience of the Dutch banking system under severe scenarios was furthermore demonstrated in July 2021 European Banking Authority stress tests of European banks, with Dutch banks displaying an impact on common equity tier 1 ratios in line with that of a European average of around 5.3%.
- **Private debt:** Private sector indebtedness remains high at around 254% of GDP as of Q2 2021. Vulnerability is particularly present with respect to household debt, of 103% of GDP (almost all of this in reflection of mortgage loans) – among the highest such ratios in Europe.
- **Financial imbalances:** Housing market inefficiencies, due to underdevelopment of the private rental market, have resulted in households turning to homeownership. At the same time, low financing costs and a generous mortgage interest deductibility scheme encourage debt accrual, with elevated loan-to-value ratios for house purchase especially among first-time buyers. Residential prices continued to grow quickly (18.3% YoY in October 2021), and price levels are 82% higher currently compared with those as of June 2013. We note positively, however, that the Dutch government is seeking to reduce household debt bias by gradually phasing down a mortgage interest deductibility mechanism. In addition, tightening macro-prudential policies are credit positive, such as a legally binding loan-to-value ratio of 100% in 2018, down from 106% in 2013, with minimum risk weights as relates to mortgages expected to come in force by 2022.

Overview of Scope's qualitative assessments for the Netherlands' *Financial Stability Risks*

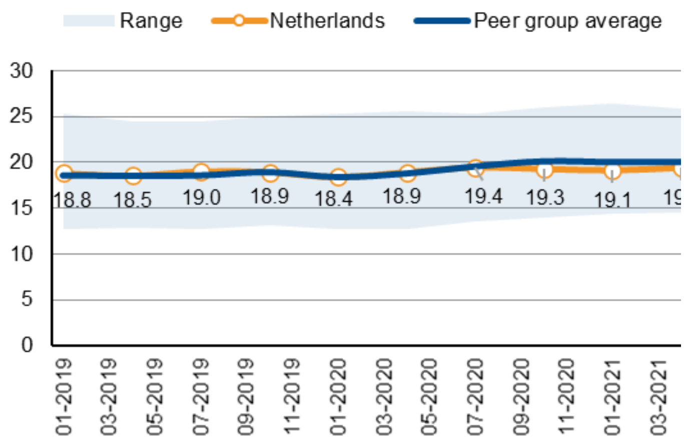
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Adequate capitalisation, comfortable liquidity levels, higher NPLs than peers
	Banking sector oversight	Neutral	0	Effective oversight under the De Nederlandsche Bank and the ECB as part of Banking Union
	Financial imbalances	Weak	-1/3	High household and private-sector indebtedness counterbalanced by savings via housing assets

NPLs, % of total loans



Source: IMF, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

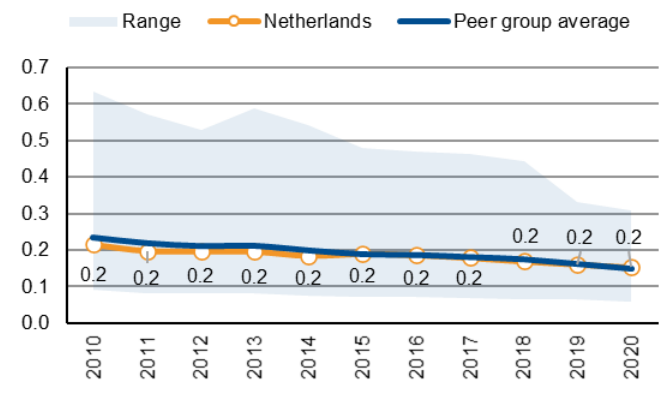
ESG Risks

- **Environment:** Due to geographical features of the Netherlands, with 60-70% of its population and economy at risk of flooding especially in heavily populated river deltas, the country is exposed to natural disaster risk. The Dutch economy is characterised by a relatively higher carbon emission intensity relative to peer economies, and the energy mix demonstrates a lower share of renewable energy use compared with peers. The government has yet to submit its Recovery and Resilience Plan to the European Commission. The incoming government intends to significantly raise ambition on green issues, seeking 55% reductions of carbon emissions by 2030 and seeking creation of a fund for the combatting of climate change of a cumulative 4.3% of annual GDP alongside another investment fund of around EUR 25bn for nature preservation and limiting nitrogen emissions.
- **Social:** Social risks point to an ageing society, in line with similar risks affecting other highly rated sovereigns. Income inequality is low under an international comparison and broadly comparable with that of Holland's indicative sovereign peer group. In addition, labour force participation of around 81% of the active labour force (aged 15-64) is above the euro area average although in line with that of the indicative sovereign peer group. This aside, social outcomes are strong and in line with those of the indicative peer group, such as very low risk of poverty (13.6% of the population under the national poverty line) and strong educational outcomes. Social challenges associate with persistent labour-market duality with a high share of persons employed part-time. Longer term, an ageing society stresses budgetary outcomes.
- **Governance:** In line with sovereign peers, Netherlands scores highly on the World Bank's Worldwide Governance Indicators. Record coalition negotiations concluded in December 2021 with agreement around a fourth Rutte government, with future government priorities centring around extension of free childcare, tackling climate change and a housing shortage, nuclear energy research and road pricing. A fractured political landscape represents a credit risk.

Overview of Scope's qualitative assessments for the Netherlands' *ESG Risks*

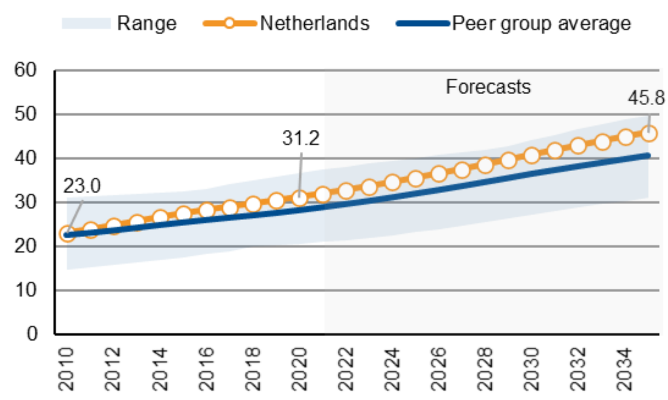
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Environmental risks	Neutral	0	High nitrogen emissions, low share of renewables, high CO_2 emissions per capita, natural disaster risk
	Social risks	Neutral	0	Weak demographics but strong social safety net; risk from rising levels of inequality
	Institutional and political risks	Neutral	0	High-quality institutions

CO_2 emissions per GDP, $mtCO_2e$



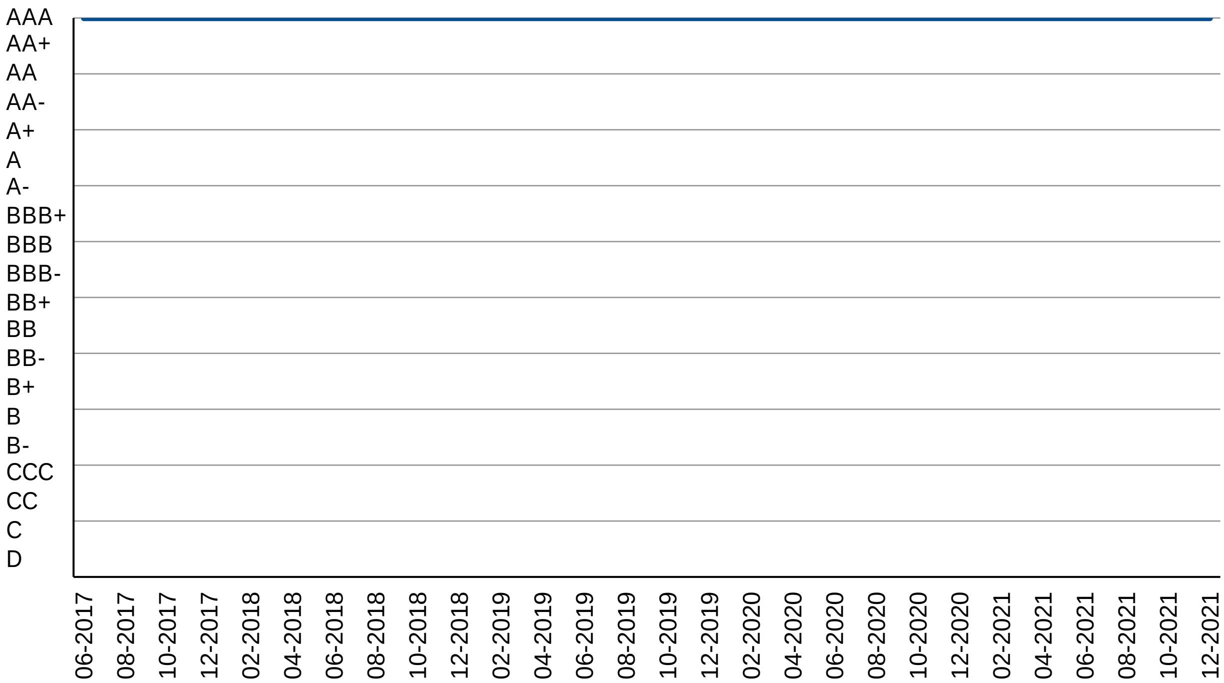
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard after the reserve-currency adjustment.

Peer group*
Austria
Denmark
Estonia
Finland
Germany
Ireland
Luxembourg
Norway
Sweden
Switzerland

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021E	2022F
Domestic Economic Risk							
GDP per capita, USD '000s	46.2	48.8	53.2	52.7	52.5	57.7	61.2
Nominal GDP, USD bn	783.8	833.6	914.5	910.3	913.1	1,007.6	1,070.8
Real growth, %[1]	2.2	2.9	2.4	2.0	(3.8)	4.4	3.1
CPI inflation, %	0.1	1.3	1.6	2.7	1.1	1.9	1.7
Unemployment rate, %[1]	6.0	4.9	3.8	3.4	3.8	3.2	2.8
Public Finance Risk							
Public debt, % of GDP[1]	61.9	56.9	52.4	47.4	52.5	59.2	58.1
Interest payment, % of government revenue	2.6	2.3	2.0	1.6	1.0	0.6	0.6
Primary balance, % of GDP[1]	1.1	2.2	2.2	3.2	(3.9)	(5.6)	(2.5)
External Economic Risk							
Current account balance, % of GDP	8.1	10.8	10.8	9.4	7.0	7.9	8.7
Total reserves, months of imports	0.5	0.5	0.4	0.5	0.7	-	-
NIIP, % of GDP	59.3	64.9	70.6	90.2	122.4	-	-
Financial Stability Risk							
NPL ratio, % of total loans	2.5	2.3	2.0	1.9	1.9	-	-
Tier 1 ratio, % of risk weighted assets	17.7	18.4	18.8	18.9	19.3	19.4	-
Credit to the private sector, % of GDP	114.6	111.1	105.5	99.7	100.9	-	-
ESG Risk							
CO_2 per EUR 1,000 of GDP, mtCO_2e	186.6	178.9	169.4	160.7	153.0	-	-
Income quintile share ratio (S80/S20), x	4.2	4.3	4.2	-	-	-	-
Labour force participation rate, %	79.7	79.8	80.3	80.9	-	-	-
Old age dependency ratio, %	28.2	29.0	29.7	30.4	31.2	32.0	32.8
Composite governance indicator[2]	1.7	1.7	1.7	1.6	1.6	-	-

[1] Forecasted values are produced by Scope
[2] Average of the six World Bank Worldwide Governance Indicators
Source: European Commission, IMF, World Bank, Macrobond, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 16 December 2021	9.4

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