Creditreform Sovereign Rating

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Rating Object	Rating Information	
KINGDOM OF THE NETHERLANDS	Assigned Ratings/Outlook: **AAA /stable**	Type: Follow-up Rating, unsolicited
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	26-08-2016 28-07-2017 “Sovereign Ratings”

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Rating Action

Neuss, 28 July 2017

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of “AAA” for the Kingdom of the Netherlands. Creditreform Rating has also affirmed the Netherlands’ unsolicited ratings for foreign and local currency senior unsecured long-term debt of “AAA”. The outlook is stable.

Key Rating Drivers

1. Outstanding quality of economic and political institutions, although rising parliamentary fragmentation could hamper efficient governing going forward
2. Highly competitive and wealthy economy; recovering house prices and favorable labor market conditions prepare the ground for robust economic growth which is set to remain in place, despite risks stemming from external demand
3. Marked progress in fiscal consolidation due to strong tax revenue growth, general government debt set to decline sharply on the back of sustained surpluses and a continuing expansion of economic activity
4. Its sound fiscal framework and high debt affordability add to the Netherlands’ strong fiscal position
5. Very strong external position as the current account surplus and the international investment position remain exceptionally high

Reasons for the Rating Decision

The Kingdom of the Netherlands’ exceptionally high creditworthiness is mainly based on its very high institutional quality. The sovereign displays a long-standing track record of forward-looking, sound, and effective policy-making. This is reflected in the World Bank’s World Governance Indicators, according to which the sovereign consistently receives very high scores on almost every indicator and can be regarded as one of the global top-performers.

That being said, the general elections in March 2017 have resulted in greater political fragmentation. The Dutch parliament now comprises 13 parties, the highest number so far (2012 election: eleven parties), which may hamper efficient policy-making to a certain

extent. However, we believe that policy continuity and a timely reaction to macro-financial shocks will be warranted, irrespective of the outcome of the coalition negotiations, which were still underway as of 04 July 2017. After two failed attempts to form a coalition between the VVD (holds 33 seats), D66 (19), CDA (19) and the GROENLINKS (14), the only option to reach a compromise and form a majority coalition appears to be VVD, D66, CDA and ChristenUni (together 76/150 seats).

At the same time, we view the very open Dutch economy as highly competitive and prosperous, which represent key credit strengths. As measured in PPP terms, the country has a per-capita income of USD 51,049, higher than the GDP p.c. of AAA peers such as Germany, Sweden or Denmark. Moreover, the Netherlands is one of the most competitive economies world-wide, having climbed one place in the World Economic Forum's Global Competitiveness ranking, the country now stands at number 4 (out of 140 economies). What is more, the economy is well-diversified with a dominant services sector and an important trade (20.9% of GVA) and financial services (7.0% of GVA) sector reflecting the country's role as a trade and financial hub.

Our assessment also factors in the Netherlands' recent solid macroeconomic performance. While the growth rate for 2015 was revised upwards from 2.0 to 2.3% by the CBS, growth in 2016 held up well, posting at 2.2%. The recovery of the Dutch economy continues to be broad-based. Thus, growth was fueled by robust export performance and strong investment activity, which was buttressed by residential investment – increasing by 19.0% (2015: 20.9%). At the same time, consumption increasingly contributes to output growth (2016: 0.5 p.p.; 2015: 0.3 p.p.). In particular, private consumption has picked up significantly (2016: +1.6%; 2015: +2.0%; 2009-14 avg.: -0.6%), owing to the favorable labor market development and rising house prices.

The Dutch labor market developed favorably. While unemployment fell sharply from 6.9 to 6.0% in 2015-16, the activity rate ticked up to 79.7% and employment increased to 74.8% of the total population (15-64y; 2015: 79.6 and 74.1%). Cost competitiveness improved slightly, as real compensation per employee increased at a lower rate than real labor productivity (0.5 vs. 1.4% in 2015-16). We believe that unemployment will continue to decline as the economy benefits from its flexible labor market. Thus, part-time employment accounted for 49.7% of total employment as compared to the euro area average of 21.6%, and the share of temporary employment stood at 17.2% (EA-19: 13.3%). Recently, the monthly average of the unemployment rate has dropped to 5.1%, after standing at 6.3% in May-16.

Meanwhile, the housing market has continued to recover, with house prices growth accelerating in 2016. According to OECD data, quarterly y-o-y growth rates averaged at 4.3% throughout the year (2015: 3.6%; 2014: 0.1%) and in Q4-16 house prices stood 5.2% above the level seen in Q4-15 – the highest yearly growth since Q3-01. By contrast, yearly mortgage credit growth had been anemic, turning positive in December 2016 (May-17: +0.3%).

Although the number of homeowners in negative equity fell from 25.6 to 17.6% in 2015-16 and affordability indicators such as the price-to-income ratio are currently standing

16.2% below its peak (Q3-08), we will closely monitor further market development against the backdrop of the very high level of private household debt. To be sure, household debt continued to fall as a percentage of GDP and came in at 121.1% in Q4-16, down from 123.9% a year before. Still, private household debt edged up to EUR 844.6bn in nominal terms (Q4-15: 838.0bn). Despite a sizeable net asset position amounting to 210.8% of GDP in Q4-16, rather illiquid insurance and pension assets make up for the most of the households' total assets (68.8%; 228.2% of GDP).

The government has begun to implement a number of measures targeted towards the reduction of household debt, in particular mortgage indebtedness and related housing market risks. In this context, mortgage interest deductibility will be gradually lowered to 38%, the maximum LTV ratio will be reduced to 100% by 2018 and as of 01 January 2017 the National Mortgage Guarantee (NHG) threshold is linked to the average house price. Also, rents are envisaged to become more market-based. On the whole, we believe that housing market risks are well addressed by the Dutch authorities, though preliminary findings indicate that LTV/LTI-tightening and the reduction of tax subsidies have only had a limited impact so far.

As regards economic prospects, we expect the growth momentum to carry over into the next quarters, as production has gathered momentum since the beginning of 2015. In the first quarter, GDP surpassed last year's level by 2.5% (Q1-16: 1.5%) and GDP growth rates of at least 2% have been recorded since Q2-16. We forecast GDP to increase by 2.2% this year and average at around 1.7% in 2018-21. The positive trend in consumer and producer confidence signals that domestic demand will continue to drive economic activity. Underpinned by the further improvement of labor market conditions and house prices, which we project to continue on their upward trajectory, private consumption spending is likely to remain solid, while investment activity should grow vividly on the back of brisk residential investment. The contribution of net exports to GDP growth will presumably be curtailed by strengthening domestic demand but hold up well against the backdrop of a benign outlook for global trade and euro area growth. The UK's decision to leave the EU may have negative repercussions, given the close trade ties and financial linkages (UK 7.5% of total trade, NL-UK direct investment: outward USD 494.6bn, inward USD 364.6bn), but we do not expect any significant impact to materialize in 2017-18.

Owing to the recent robust economic activity, social payments were lower and the increase in revenues from taxes on income, wealth and production was more pronounced than expected. On the general government level, this resulted in significantly higher revenues and lower expenditure – not only relative to GDP but also in nominal terms. Thus, expenditure was dented by 0.9% to EUR 304.1bn (43.6% GDP), while revenues leapt by 4.9% to EUR 307.0bn (44.0% GDP). Hence, the sovereign realized its first surplus since 2008, with the headline balance sharply increasing from -2.1% to 0.4% of GDP in 2015-16 – outperforming the target from the stability program 2016 (-1.7% of GDP) by far. Accordingly, government debt dropped by almost 3 p.p. to 62.3% of GDP last year. This is all the more remarkable in view of the fact that the government had provided a notable fiscal stimulus ('5bn package') amounting to 0.7% of GDP, which included an income tax rate cut, a rise in the employment tax credit, an increase in the top-rate threshold, and

higher subsidies for childcare. Additionally, the sovereign has recorded a significant decline in gas revenues. Natural gas extraction continues to be scaled down substantially and exports of natural gas have declined rapidly, falling by 21.5% to EUR 8.2bn in 2016. As a result, natural gas revenue fell to 0.3% of GDP in 2016, after averaging at 1.8% of GDP in 2006-15.

We expect the debt-to-GDP ratio to fall below 60% this year and approach the 50%-mark by 2020, driven by upbeat economic prospects and sustained primary surpluses. Noteworthy discretionary measures envisaged for 2017 include the elimination of self-administrated pension savings by director-major shareholders (DGA) as well as structural adjustments in the form of general tax credits, tax credits for the elderly, healthcare benefits, as well as a rent allowance. It has to be noted that the government's multi-annual plan ends this year, however we view fiscal sustainability risks as limited due a long-standing track record of prudent policy-making, sound fiscal policy framework and very high debt affordability.

On the other hand, there may be some upside risks to the budget as proceeds related to the privatization of ABN Amro, Propertize, or ASR may generate considerable funds. In June 2017 the government announced that it would reduce its stake in ABN Amro down to 63% by selling 7% worth EUR 1.5bn (0.2% of 2016 GDP). Having said this, public guarantees remain on a high level, albeit decreasing from 28.9% of GDP in 2015 to 24.5% of GDP at the end of 2016.

Fiscal sustainability risks arising from the banking sector appear to be contained. Despite the large-scale banking sector, which accounted for roughly half (Q4-16: 360.8% GDP) of the Dutch financial sector with total assets of approx. 750% of GDP, banks have built up notable capital buffers, raising their regulatory tier 1 capital to 17.75% of risk-weighted assets (Q4-16; Q4-15: 16.19%). Furthermore, they display a comparatively low and declining NPL ratio, which stood at 2.53% at the end of 2016. The stress test conducted in the course of the IMF Financial System Stability Assessment 2017 showed Dutch banks to be largely resilient and that the authorities have enhanced financial sector supervision over the recent years.

In general, pension funds continue to be vulnerable to asset price volatility and interest rate risks. The low interest rate environment continued to put pension funds under pressure in 2016. According to DNB data, the coverage ratio of Dutch pension funds slipped to 96% in Q1-16. Towards the end of last year the funding ratio appears to have turned the corner, reaching 105% in Q1-17 (May-17: 106%) after posting below the 105% threshold since mid-2015. The government has begun to tackle the issue of making the pension system more resilient. It submitted the so-called Perspective Memorandum on the Future Pension System to the House of Parliament on 08 July 2016 in which the road map for implementing reforms is outlined. However, it remains to be seen whether the new pensions system can be introduced by 2020 as stipulated.

In addition, pension funds have accumulated large savings over the years, mostly in the form of shares and securities other than shares (approx. 90% of total assets in Q4-16). Importantly, these have been investing predominantly abroad, as indicated by DNB 'look

through' data which shows approx. 84% of pension funds' assets in investment funds to be invested outside the Netherlands.

We view the country's strong external position as a credit positive. Large savings by NFCs and private households continue to drive the Dutch current account surplus, which remained very high at 8.4% of GDP – the highest reading in the EU-28. As compared to the previous year (8.8% of GDP), the surplus narrowed as the primary income deficit widened from 0.4 to 1.1% of GDP. We expect that the current account surplus is likely to moderate somewhat, mainly due to lower natural gas sales and strengthening domestic demand (see above), but will stay comfortably above 7% of GDP. At the same time, the extraordinarily high net international investment position (NIIP) continued to rise rapidly and we expect it to remain on its upward trajectory, reflecting the improving net FDI and net portfolio investment position (2016: 101.2 and -52.5% of GDP, respectively). Thus, the NIIP jumped from 63.5 to 72.3% of GDP in 2015-16.

Rating Outlook and Sensitivity

Our Rating outlook on the long term sovereign rating of AAA is stable, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – will remain fundamentally unchanged in the near term.

The sovereign credit rating could be lowered if economic activity expands at a substantially lower rate over the medium term and/or if we observe significant fiscal slippages. Weak growth may particularly be prompted by external demand. In this regard, challenges posed by the UK's decision to leave the EU are visible on the horizon. Although our baseline scenario is an orderly EU-exit, we believe that any EU-UK-agreement involves a lower degree of economic integration and harbors significant risks for the Dutch economy due to close trade and investment ties. Considerable fiscal risks mainly stem from contingent liabilities related to public guarantees (housing market (NHG), financial sector, and ESM guarantees).

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Ratings*

Long-term sovereign rating	AAA /stable
Foreign currency senior unsecured long-term debt	AAA /stable
Local currency senior unsecured long-term debt	AAA /stable

*) Unsolicited

Economic Data

[in %, otherwise indicated]	2011	2012	2013	2014	2015	2016	2017e
Real GDP growth	1.7	-1.1	-0.2	1.4	2.3	2.2	2.2
GDP per capita (PPP, USD)	46,309	46,4911	47,0153	48,3616	49,6236	51,049	53,139
Inflation rate, y-o-y change	2.5	2.8	2.6	0.3	0.2	0.1	1.6
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	81.2	81.1	81.3	81.7	81.7	n.a.	n.a.
Fiscal balance/GDP	-4.3	-3.9	-2.4	-2.3	-2.1	0.4	0.5
Current account balance/GDP	8.7	10.3	9.9	8.9	8.8	8.4	n.a.
External debt/GDP	477.3	531.9	534.2	491.9	526.1	501.3	n.a.

Appendix

Regulatory Requirements

This sovereign rating is an unsolicited credit rating. Neither the rated sovereign nor a related third party participated in the credit rating process. Creditreform Rating AG had no access to the accounts, representatives or other relevant internal documents for the rated entity or a related third party.

The rating was conducted on the basis of Creditreform Rating´s "Sovereign Ratings" methodology. Creditreform Rating AG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of Creditreform Rating´s rating methodologies is published on the following internet page: www.creditreform-rating.de.

A Rating Committee was called consisting of highly qualified analysts of Creditreform Rating AG. The quality of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with and that the rating action was and is free of any existing or potential conflicts of interest. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in Creditreform Rating´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

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