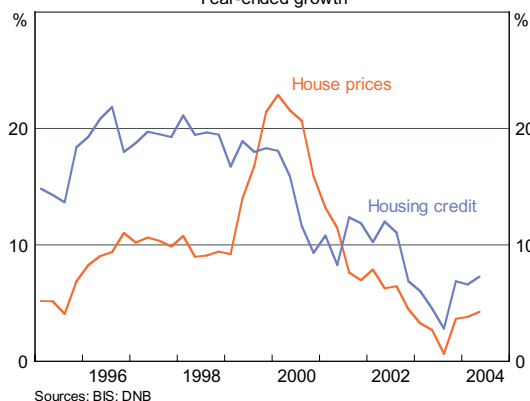
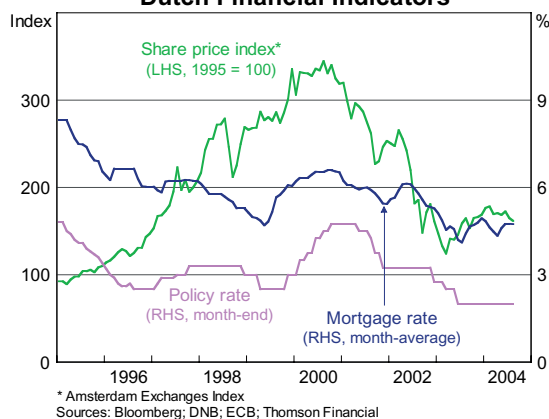


Box B: The Housing Market Slowdown in the Netherlands

Graph B1
Dutch Housing Market Indicators
 Year-ended growth



Graph B2
Dutch Financial Indicators



Developments in household balance sheets in the Netherlands during the second half of the 1990s share similarities with recent experience in Australia. In the period from 1995 to 2000, housing credit and house prices rose strongly, reflecting a combination of low interest rates, financial innovation, an extended period of strong economic growth and favourable tax treatment for owner-occupier loans. In 2000, year-ended growth in house prices peaked at more than 20 per cent and housing credit growth slowed noticeably. Subsequently, the growth rate in house prices has declined significantly, although prices have not fallen (Graph B1).

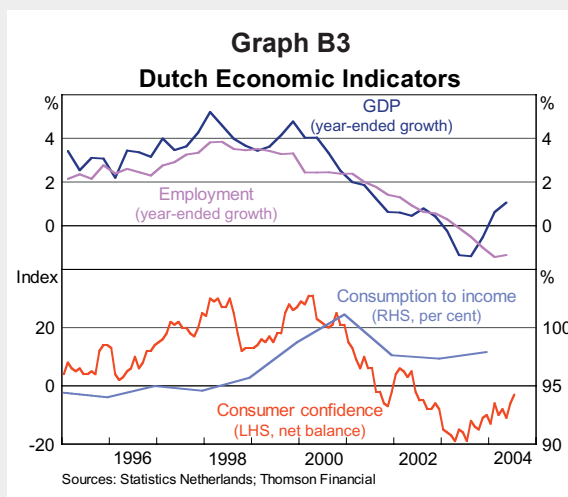
The housing market slowdown was associated with a combination of financial and macroeconomic developments. Dutch mortgage rates, which are predominantly fixed, rose sharply from June 1999, reflecting developments in global bond markets and anticipated monetary policy tightening. In November 1999, the European Central Bank raised the policy rate by 50 basis points, the first part of a cumulative 225 basis point tightening (Graph B2).

Weakness in the share market, which gathered pace in 2001, also appears to have weighed on the housing market. In particular, the popularity of equity-linked mortgage products is likely to have generated a procyclical influence of equity prices on the Dutch housing market, encouraging additional borrowing when equity prices rise and discouraging borrowing when

equity prices fall. Surveys commissioned by De Nederlandsche Bank indicate that equity-linked mortgages accounted for 48 per cent of mortgages taken out in 2001-02, up from 19 per cent in 1991-95.¹

Tax reform also played a role in dampening the housing market. In particular, the benefits of mortgage interest deductibility were reduced in 2001 through limits on the eligibility of deductions and a reduction in marginal income tax rates.

The turnaround in the housing and credit markets was associated with a marked slowing in the pace of economic activity (Graph B3). GDP growth slowed across Europe, with several countries, including Germany, falling into recession. The deceleration was especially pronounced in the Netherlands, which went from being one of the fastest growing economies in Europe, to one of the weakest over 2003. The slowing was particularly evident in household consumption. Over the period from 1995 to



2000, Dutch real consumption grew at an average annual rate of 4 per cent, underpinned by strong growth in housing assets, debt and consumer confidence. In contrast, in the following three years, real consumption fell. The shift is reflected in the household saving ratio, which after falling by 7½ percentage points between 1995 and 2000, has subsequently risen by 4½ percentage points.

The large turnaround in GDP and consumption growth can be partly explained by the dynamics of the house price cycle. Research suggests that housing-secured borrowing used for purposes such as home improvement and consumption boosted GDP growth by around 1 percentage point in each of 1999 and 2000, and subtracted around ½ a percentage point from growth in each of 2001 and 2002.²

The effect of recent developments is clearly evident on financial institutions. After growing strongly for a number of years, the revenue of the banking system declined in 2001 and 2002, partly due to the sharp slowing in credit growth (Table B1). Bad debt costs also increased over these two years, with total provisioning expenses in 2002 almost three times that in 2000. Much of the increase, however, was related to the deterioration in the quality of business loan

1 De Nederlandsche Bank (2003), Quarterly Bulletin, June, p 14.

2 van Els, PJA, WA van den End and MCJ van Rooij (2003), 'Financial Behaviour of Dutch Households: Analysis of the DNB Household Survey 2003', De Nederlandsche Bank, Research Memorandum WO no. 744/Meb-Series no. 2003-09.

portfolios, rather than mortgage portfolios. As economic conditions have improved over the past year, revenue growth has again picked up and bad debts expense has fallen. Notwithstanding these fluctuations, Dutch banks have remained highly profitable.

Table B1: Dutch Banking Sector

€ billion, unless otherwise indicated

	1998	1999	2000	2001	2002	2003
Revenue	31.8	38.3	45.1	44.8	44.3	45.8
Provisioning expenses	2.6	2.1	1.8	3.6	5.1	3.6
Operating profit before tax	6.7	10.1	12.1	9.5	8.1	11.4
Return on equity (per cent) ^(a)	14.3	17.8	17.3	15.2	11.6	15.3

(a) Before tax and outside equity interests.

Source: DNB