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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL AND TO THE EUROGROUP

Results of in-depth reviews under Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances

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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL AND TO THE EUROGROUP

Results of in-depth reviews under Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances

1. INTRODUCTION

The on-going economic and financial crisis has prompted a profound restructuring of our economies. This needs to be accompanied by a new kind of economic governance in the EU that recognises the interdependence between our economies and which builds the foundations for future growth and competitiveness that will be smart, sustainable and inclusive.

Correcting the problems of the past and putting the EU on a more sustainable development path for the future is a shared responsibility of the Member States and the EU Institutions, as our economies are closely intertwined.

In the decade leading up to the outbreak of the crisis, not enough attention was paid at the EU level to developments in the economies of individual Member States. This was due in part to an insufficient recognition of the spillover effects of economic policies pursued in one Member State on the economies of other Member States – spillover effects that were particularly acute in the euro area, due to the close economic interdependence of countries sharing a currency. But it was also in part due to the lack of tools at the disposal of the EU to help detect, prevent and where necessary correct such imbalances. As a result, imbalances were allowed to develop unchecked, with negative consequences both for the economies of several Member States and for the proper functioning of the Economic and Monetary Union.

Drawing on the lessons of the past and determined to avoid repeating similar situations in the future, the EU has put in place a new system of economic governance. As part of this new way of working, on a proposal of the Commission, the legislator set up a Macroeconomic Imbalances Procedure (MIP) to help detect, prevent and correct problems at an earlier stage (Regulation (EU) No 1176/2011, hereafter 'the Regulation'). The MIP – together with the reinforced Stability and Growth Pact, with its focus on sustainable public finances – is at the heart of the EU's strengthened economic governance.

While decisive policy action by Member States and at EU-level is helping to rebalance the EU economy and indicators suggest that previous competitiveness losses are gradually being reversed, the imbalances that built up over several years in some EU economies continue to pose daunting challenges. In particular, the need to bring unsustainable levels of public and private debt under control and to get a better balance between income and expenditure is temporarily dampening economic activity and employment. In some cases this situation is exacerbated by the persistence of deep-rooted structural rigidities in some countries' economies, which limit the adjustment capacity and has aggravated the unbearably high levels of unemployment. These factors are recognised in the Commission's 2013 Winter Forecasts which indicate that the return to sustained growth will be gradual.

While the situation varies from one Member State to another, continued reform is needed in all of them. Structural reforms take time to support growth and job creation,

which in turn would reduce pressures on public finances. That is why a credible medium-term fiscal strategy and a comprehensive set of structural reforms complement each other. The new EU economic governance tools are designed to help governments to pick up underlying problems and to address them without delay, pursuing appropriate and country specific policies within a wider European framework. The EU institutions and Member States are working closely together, recognising the interdependence of the Euro area and of the wider EU which necessitates deeper, shared decision-making.

This is the comprehensive approach that underpinned the Commission's 2013 Annual Growth Survey[1] at the start of this third cycle of the European Semester of economic policy coordination. As part of this process in its Alert Mechanism Report[2], the Commission screened all Member States[3] for possible macroeconomic imbalances on the basis of a scoreboard of indicators as part of the Macroeconomic Imbalances Procedure. The scoreboard has been established by the Commission after consultation with the European Parliament and the Council, as well as the European Systemic Risk Board. These indicators support the economic analysis of the situation of each Member State with regard to internal imbalances (such as private and public debt levels, house prices, unemployment) and external imbalances (such as the current account, international assets and liabilities and competitiveness indicators). As a result, fourteen Member States were selected for further in-depth reviews.

The origin, nature and gravity of the imbalances identified by this process differ across Member States and require a country-specific approach. The need for policy action to support significant adjustment is particularly pressing in those Member States that have been experiencing persistent and large current-account deficits and competitiveness losses. In a comprehensive study published in December 2012, the Commission also looked at the reasons for large and persisting current account surpluses[4]. While current account surpluses should be a sign of healthy competitiveness, they can also reflect market failures or a weakness of domestic demand and investment opportunities. The macro-economic imbalances observed in the EU resulted in a misallocation of resources in surplus countries with negative implications for growth.

Based on the analysis presented the in-depth reviews (IDR) accompanying this Communication, the Commission has identified imbalances in all countries selected in the Alert Mechanism Report: **Belgium, Bulgaria, Denmark, Spain, France, Italy, Hungary, Malta, the Netherlands, Slovenia, Finland, Sweden** and **the United Kingdom)[5]**. Section 2 summarises the broad conclusions that can be drawn from this analysis. Section 3 presents the main findings country by country[6]. Section 4 draws

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1 COM(2012) 750, 28.11.2012.

2 COM(2012) 751, 28.11.2012.

3 With the exception of the programme countries.

4 European Commission, Directorate-General for Economic and Financial Affairs: "Current Account Surpluses in the EU", *European Economy* 9/2012.

5 No IDR is published for Cyprus, given the political agreement reached between the Eurogroup and the Cypriot authorities on the key elements of a macroeconomic adjustment programme and official financing. Programme countries are not covered by the MIP, as they are under enhanced economic surveillance in the scope of the economic adjustment programme linked to the financial assistance they receive. This principle has now been confirmed with the approval of the so-called "two-pack", that consists of two regulations to further strengthen the economic pillar of the Economic and Monetary Union. The implementation of MIP has also been suspended for Greece, Ireland, Portugal and Romania.

6 This Communication fulfils the requirement of Articles 6(1) and 7(1) of Regulation (EU) No 1176/2011 (the MIP Regulation), according to which the Commission informs the European

some brief conclusions and outlines the next steps in this process of EU economic governance.

2. MAIN CROSS-COUNTRY FINDINGS FROM THE IN-DEPTH REVIEWS

Macroeconomic adjustment is taking place though with differences in nature and pace across the Member States. This adjustment is documented in the IDRs**,** which provide data and discuss key factors such as reductions in current account deficits, convergence in unit labour costs, corrections in excessive housing prices and reductions in private sector indebtedness. Given different challenges and imbalances, cross-country growth differences are expected to persist in the coming years[7].

Weak economic activity and the fragile economic outlook in some cases may have aggravated both the risks and the cross-country spillovers arising out of the macroeconomic imbalances which have been analysed. Moreover, in most cases the adjustment process is not yet complete. In particular, the accumulated stocks of external liabilities (as measured by the large and negative net international investment positions and the net external debt), private indebtedness and the housing market situation in some Member States continue to pose challenges. Overcoming these challenges will determine whether indebted economies can grow and compete, ensure financial stability and succeed in reducing unemployment. **In several Member States the macroeconomic imbalances identified will need to be closely monitored and to be tackled through a decisive commitment to structural reform.** Many of the measures which need to be taken to ensure smooth absorption of the external and internal imbalances also promote medium-term economic growth. As such, the EU strategy to boost medium-term growth and investment includes the policy responses that should be taken in the context of the MIP.

The IDRs illustrate in particular that:

- The adjustment of **external positions** is underway, although the high level of net external liabilities continues to make several Member States vulnerable.

- In spite of improvements in export performance, which result from gains in cost-competitiveness, several Member States need to step up efforts to boost or regain **competitiveness**, both inside the Internal market and globally.

- **Non-cost competitiveness factors** remain crucial, for example action is needed on export composition and technological content, geographical diversification of exports, firms' structure, the imported contents of exports, the role of intermediary inputs, and investment in R&D and innovation.

- **Deleveraging** is occurring in the private sector of several economies, but private debt levels remain high and the deleveraging pressures remain strong.

- **Housing markets** are in the adjustment phase in a number of countries which experienced pre-crisis housing booms. Further downward adjustments cannot be

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Parliament, the Council, the Eurogroup and the ESRB whether imbalances exists on the basis of the IDRs. The IDRs are published in line with Article 5(3), in parallel with this Communication. In respect of Article 7(1), it also informs in which cases the Commission considers the imbalances to be excessive.

[7] See the Commission services' winter forecasts, which were released on 22 February 2013, *European Economy*, 1(2013).

excluded, against a background of a still vulnerable banking sector, tightened credit conditions and economic uncertainty.

3. FINDINGS BY MEMBER STATE

This section outlines the analysis in the in-depth reviews per country and, as required by the Regulation, indicates where the Commission considers imbalances to exist and where it considers such imbalances to be excessive.

BELGIUM is *experiencing macroeconomic imbalances, which deserve monitoring and policy action.* In particular, macroeconomic developments in the areas of external competitiveness of goods, and indebtedness, especially concerning the implications of the high level of public debt for the real economy, continue to deserve attention.

More specifically, Belgium has experienced a long-term decline in its export market shares due to persistent losses in both cost and non-cost competitiveness. While Belgian goods exports are gradually being reoriented towards more dynamic regions, the specialization in cost-sensitive intermediate products is intensifying. The latter highlights the role played by cost factors in Belgium's export performance with labour costs outpacing the trends observed in trading partner countries. Over the last year, the Government has announced and started actions to curb the widening wage gap. However, this correction is expected to be protracted at best so that the problem will last over the medium term, while several trading partners are pursuing competitiveness-enhancing reforms. In terms of non-cost competitiveness the imperfect transmission of research activities into the development of new products with a higher technological content is one area that needs action. The overall loss of competitiveness aggravates problems arising from the large public debt as it weighs on growth prospects. The high public debt exposes Belgium to financial turbulence, with important contingent liabilities for the financial sector representing an additional risk. Over a longer-term horizon fiscal sustainability will also have to be reconciled with the budgetary impact of an ageing population.

BULGARIA is *experiencing macroeconomic imbalances, which deserve monitoring and policy action.* In particular, the impact of deleveraging in the corporate sector as well as the continuous adjustment of external positions, competitiveness and labour markets deserve continued attention.

More specifically, Bulgaria rapidly built up imbalances during the boom phase that coincided with its accession to the European Union. In a context of catching up, high foreign capital inflows contributed to the overheating of the domestic economy and a booming housing sector. With the onset of the crisis, Bulgaria embarked on a fast process of deleveraging and has taken measures to maintain financial stability. While Bulgaria experienced a quick and important adjustment of its current account, moderate deficits are expected to resume as the economic recovery will lead to higher imports. This will slow down adjustment in the net external indebtedness. To sustain cost competitiveness and export growth, it will be important to ensure that unit labour cost are supported by productivity gains. Non-financial corporate sector indebtedness, including an increase in late payments, suggest that deleveraging pressures are impeding more dynamic economic growth. The low-skilled segment of the labour market seems to have been especially hard-hit by the crisis and warrants close attention. Unemployment has increased sharply, and steps should be taken to prevent unemployment from becoming more structural in nature. Skills mismatches can be seen in emerging labour shortages in some sectors, pointing to a need for a

comprehensive package of active labour market, education and regional policies. On the way forward, the challenges for Bulgaria include the need to increase the adjustment capacity of the labour market, to enable smooth corporate sector deleveraging and to avoid re-emergence of unsustainable imbalances.

DENMARK is *experiencing macroeconomic imbalances, which deserve monitoring and policy action.* In particular, the continuing adjustment in the housing market and the high level of indebtedness in the household and private sector as well as drivers of external competitiveness, deserve continued attention.
More specifically, there has been a weak export performance linked to a rise in unit labour costs due to high wage growth and, in particular, weak productivity growth. Furthermore, the weak export performance is partially due to an unfavourable export market mix. In recent years there have been some improvements in this regard, but at the current juncture it is difficult to assess their sustainability and durability. Taking into account that Denmark has been experiencing high and rising current account surpluses, these trends do not point to short term risks. Low interest rates and an acceleration of house prices in the years prior to the financial crisis contributed to a surge of household debt to unsustainable levels. While a reversal of this trend has been set in motion and risks are also attenuated by high net asset positions of households, the correction process will have to stretch over a significant period of time. This poses potential risks to economic and financial stability.

SPAIN is *experiencing excessive macroeconomic imbalances. Although adjustment is taking place, the magnitude of the necessary correction requires continuous strong policy action.* In particular, very high domestic and external debt levels continue to pose risks for growth and financial stability. The decisive policy action at the EU level and by Spain has resulted in a visible adjustment of flows, reduction in financing costs and a reduction of immediate risks. However, developments over the last year, including further contraction in economic activity, soaring unemployment, and the need for public support for the recapitalisation of a number of banks, have exposed the vulnerabilities represented by those imbalances for growth, employment, public finances and financial stability.
More specifically, Spain has been affected by large and closely interconnected external and internal imbalances. Strong capital inflows during the boom years contributed to the accumulation of large net external liabilities and spurred a large housing and construction bubble. After this bubble burst, the exposure of the banking sector to doubtful real estate and construction assets endangered financial stability. These risks to the banking sector are being effectively addressed through the financial sector assistance programme and the recapitalisation and restructuring of the most affected banks and the strengthening of the regulatory and supervisory framework[8]. The adjustment of external imbalances is on-going but not completed yet, as Spain needs to move towards a persistent current account surplus to reduce its stock of net external liabilities: currently part of the improvement in the current account balance and cost competitiveness may be driven by cyclical factors. The adjustment of private sector balance-sheets is advancing, but will continue to pose a challenge for economic growth and the fiscal outlook over the medium term. The housing market has not stabilised yet. Rigidities in product and labour markets contribute to high and rising

[8] See the Commission, services' reports on the financial assistance programme to recapitalise financial institutions in Spain, *European Economy-Occasional Papers,* 118, 121, 126 and 130.

unemployment, and more generally hinder the adjustment of the economy. All in all, vulnerabilities to possible real and financial shocks remain elevated, and with them the possibility of negative spill overs on the rest of the euro area. These challenges require continued action in the areas of product and service markets, labour market, financial sector, and public finances.
In addition, significant revenue shortfalls linked to the rebalancing of the economy, higher social expenditure and costs of bank recapitalisation have led to a substantial pressure of government deficits and a steeply rising government debt. A sustainable correction of the excessive budget deficit in the medium-term requires simultaneous progress on correcting macroeconomic imbalances, supported by further structural reforms to boost growth and employment creation and to reduce structural rigidities that hamper the adjustment.

FRANCE is *experiencing macroeconomic imbalances, which require monitoring and decisive policy action.* In particular, the deterioration in the trade balance and competitiveness levels, driven both by cost and non-cost factors, against a background of a deteriorating external position and high public debt deserves continued attention. The need for action so as to reduce the risk of adverse effects on the functioning of the French economy and of the Economic and Monetary Union, is particularly important notably given the size of the French economy.
More specifically, the growing trade deficit reflects the long term decline in export market shares which is linked to persistent losses in both cost and non-price competitiveness. Wages have risen fast and put pressure on prices and firms' profitability. The low and decreasing profitability of private companies, in particular in the manufacturing sector, have not only weighed on their indebtedness, but more importantly may have hampered their ability to innovate and to strengthen their non-price competitiveness. Other factors, including the decreasing number of exporting firms have aggravated these competitiveness issues. In particular, rigidities in the French labour market, which also contributed to the development in the cost of labour, may have limited the potential for adjustment of the economy and hampered productivity developments. In addition to the competitiveness issues, the rising public debt exposes France to potential financial market turbulence and brings risks of crowding out private investment.

ITALY is *experiencing macroeconomic imbalances, which require monitoring and decisive policy action*. In particular, export performance and the underlying loss of competitiveness as well as high public indebtedness in an environment of subdued growth deserve continued attention in a broad reform agenda in order to reduce the risk of adverse effects on the functioning of the Italian economy and of the Economic and Monetary Union, notably given the size of the Italian economy.
More specifically, in a context of elevated risk aversion in financial markets, Italy's high public debt weighs on the country's growth prospects through several channels, in particular the high tax burden needed to service the debt, funding pressures for Italian banks and thus for the private sector, increased macroeconomic uncertainty and a severely limited margin for countercyclical fiscal policies and growth-enhancing public expenditure. In order to put the high public debt-to-GDP ratio on a steadily declining path, Italy has been pursuing a strategy of sizeable fiscal consolidation, but subdued growth prospects make it challenging – but even more essential – to achieve and sustain the necessary large primary surpluses. Italy's

declining external competitiveness since the late 1990s is reflected in substantial export market share losses. Stagnant productivity, outpaced by labour cost growth, has implied increasing unit labour costs compared to peers, and the sizeable appreciation of Italy's nominal effective exchange rate between 2003 and 2009 further undermined cost competitiveness. The high tax burden, especially on labour and capital, also negatively affects competitiveness. In addition, Italy's export performance continues to suffer from an unfavourable product specialisation, and the country's weak human capital endowment hampers a move towards a technologically more advanced specialisation model. Institutional and regulatory barriers, an unfriendly business environment and structural firm-level features hinder the ability of many Italian companies to grow, limiting productivity gains and international expansion. These factors also limit the inflow of foreign direct investment, thus missing out on a further important potential source of productivity enhancements. Finally, the double-dip recession has seriously weakened the ability of the Italian banking sector to support the adjustment needed to address imbalances.

HUNGARY is *experiencing macroeconomic imbalances, which deserve monitoring and decisive policy action*. In particular, the on-going adjustment of the highly negative net international investment position, largely driven by private sector deleveraging in a context of high public debt and a weak business environment continue to deserve very close attention so as to reduce the important risks of adverse effects on the functioning of the economy.
More specifically, Hungary is adjusting its large stocks of external and internal (public and private) debt, a process that should be continued in the midterm. For the third year in a row, the NIIP has been improving thanks to current account surpluses. This is mainly a result of falling domestic demand, driven by an on-going private sector deleveraging (mostly in the household sector). At the same time, a rapid fall in corporate credit supply (exacerbated by policy uncertainty and high surtaxes on the financial sector) has contributed to historically low investments. This has increased Hungary's vulnerability, further reduced the outlook for potential growth and sustained a high level of unemployment, which makes adjustment and fiscal consolidation more difficult. Public debt, which is relatively high when compared with neighbouring countries, has decreased. This is linked to a number of fiscal consolidation measures as well as a one-off receipt from the abolition of the mandatory private pension scheme. Nevertheless, uncertainty in the policy environment, a low growth potential coupled with a high share of foreign currency denominated debt and elevated public and private sector indebtedness, may have an important impact on Hungary's financing conditions which might become more difficult in the future.

MALTA is *experiencing macroeconomic imbalances, which deserve monitoring and policy action.* In particular, the long-term sustainability of the public finances warrants attention while the very large financial sector, and in particular, the strong link between the domestically-oriented banks and the property market poses challenges for financial stability and deserves continued monitoring.
More specifically, the long-term sustainability of public finances is at risk due to the high projected cost of ageing and other sizeable contingent liabilities. While the real estate market does not appear to be exposed to an immediate risk of boom and bust, ensuring its proper functioning is of particular importance for financial stability. To

this purpose, regular monitoring of developments in the property market appears warranted. Risks to domestic financial stability stemming from the presence of a very large financial sector should not be overstated, given the very limited exposure of internationally-oriented banks to the domestic economy, but continued regular monitoring of the activities of the internationally-oriented and the non-core domestic banks is important. Furthermore, the stability of the core domestic banks would benefit from further measures to strengthen loan loss provisions to limit risks arising from their exposure to the property sector.

THE NETHERLANDS are *experiencing macroeconomic imbalances, which deserve monitoring and policy action.* In particular, macroeconomic developments regarding private sector debt and deleveraging pressures, also coupled with remaining inefficiencies in the housing market deserve attention. Although the large current account surplus does not raise risks similar to large deficits, the Commission will also continue monitoring the developments of the current account in the Netherlands. More specifically, rigidities and distortive incentives have built up over decades to shape house financing and sectorial savings patterns. Balance sheets of financial institutions became heavily geared towards housing finance, as households leveraged up against housing wealth. In parallel, since the mid-1990s non-financial corporations moved into a structural savings surplus. This has resulted in a substantial and persistent current account surplus going hand-in-hand with a high level of both gross household debt and household assets. At the current juncture, feedbacks from the housing market to the real economy, notably through negative wealth and confidence effects, are weighing on economic activity.

FINLAND is *experiencing macroeconomic imbalances, which deserve monitoring and policy action.* In particular, the substantial deterioration in the current account position and the weak export performance, driven by industrial restructuring, as well as cost and non-cost competitiveness factors, deserve continued attention.
More specifically, the loss in competitiveness weakens the country's economic position and risks compromising future prosperity and living standards, especially as population ageing already poses a challenge in this regard. Finland has rapidly lost world market shares and the current account balance has been on a downward trend, and even turned into a deficit in 2011, which is forecast to widen. The decline of the current account balance seems mainly driven by deteriorating non-price competitiveness and delays in the necessary restructuring in some industries. In addition, cost-competitiveness suffers from significant increases in unit labour costs as a result of wage settlements that did not fully reflect the drop of productivity during the crisis and/or sectorial productivity developments. Finland is exporting intermediate and investment goods mainly to mature, slow growing economies and industry is vulnerable to energy price increases and the consequent deterioration in the terms of trade. In contrast, risks related to housing and household indebtedness appear relatively limited. The main concern in this respect relate to the financial position of Finnish households, with low savings rates and a net overall borrowing position.

SLOVENIA is *experiencing excessive macroeconomic imbalances. Urgent policy action is needed to halt the rapid build-up of these imbalances and to manage their unwinding.* Until now, the levels of private and public debt are below the alert thresholds of the scoreboard and also net external debt is relatively contained.

However, in a context of accelerating negative economic trends, the risk to financial sector stability stemming from corporate indebtedness and deleveraging is substantial, including through interlinkages with the level of sovereign debt. These risks are compounded by limited adjustment capacity in labour and capital markets and by an economic structure dominated by state-ownership. Periods of policy uncertainty and legal obstacles to reforms have prevented Slovenia from addressing its imbalances adequately and enhancing its adjustment capacity, thus increasing its vulnerability at a time of heightened sovereign funding stress.
More specifically, Slovenia continues to struggle with the legacy of its previous boom. Companies are still unsustainably over-indebted, leading to further rises in non-performing loans. While the size of the Slovenian banking sector is relatively small and less than half of the euro area average, the main banks are thinly capitalised in view of the continuing deterioration of their credit portfolios and their dependence on the state for capital is a major threat to the economy. At the same time, the state is itself subject to funding pressures. Necessary deleveraging is underway, but the process is hampered by labour and capital market frictions and severely depressed output levels. Corporate reliance on bank finance and the complex nexus of state ownership limit adjustment and distort resource allocation. Past cost competitiveness losses have not been reversed and current minimum wage policies risk triggering further losses in the future when the labour market starts to recover. Lack of adjustment, poor cost-competitiveness and state-ownership combine to deter private and foreign direct investment. Export market shares have been lost and export performance is substantially weaker than in peer countries. These challenges require urgent action in the areas of the financial sector, state-owned enterprises and microeconomic reforms in order to prevent a situation in which severe imbalances would steeply increase towards unsustainable levels.
Recurrent episodes of sovereign funding pressure underscore the need to pursue fiscal consolidation in tandem with structural reforms. Sustainable improvements in financial stability and macroeconomic outcomes require a coherent strategy including public finances.

SWEDEN is *experiencing macroeconomic imbalances, which deserve monitoring and policy action.* In particular, macroeconomic developments regarding private sector debt and deleveraging, coupled with remaining inefficiencies in the housing market deserve continued attention. Although the large current account surplus does not raise risks similar to large deficits in other countries, the Commission will continue to monitor developments of the current account in Sweden.
Some deleveraging has taken place in the non-financial corporate sector. Recent reforms in company taxation are likely to further reduce the level of corporate debt by limiting tax minimisation by multinational companies. Household debt has stabilised but the main contributing factors – the debt-bias in housing taxation and the slow mortgage amortisation pace – remain in place. Low interest rates on mortgages also contribute to debt build-up. On the other hand, various indicators of household leverage as well as credit supply and demand conditions do not indicate imminent deleveraging pressures. The housing market has been stable over the last year and concerns about a possible overvaluation have subsided. Yet, the housing market remains a potential source of instability for the future. Despite some recent measures, housing supply remains constrained by cumbersome planning processes, limited competition within the construction sector and regulation of rental markets. Together

with debt-bias housing taxation, these inefficiencies tend to create an upward-bias in house prices and in household indebtedness.

THE UNITED KINGDOM is *experiencing macroeconomic imbalances, which deserve monitoring and policy action.* In particular, macroeconomic developments in the areas of household debt, linked to the high levels of mortgage debt and the characteristics of the housing market, as well as unfavourable developments in external competitiveness, especially as regards goods exports and weak productivity growth, continue to deserve attention.
More specifically, the UK faces tensions between the needs for deleveraging, maintaining financial stability and avoiding compromising investment and growth. The primary cause of the growth in household debt was high and volatile house prices, linked to an insufficient and rigid supply of housing. Household deleveraging continued in 2012 and house prices corrected further but this may not be sustained once the economy improves and housing transactions return to more normal levels. Policy measures have been introduced aiming at increasing residential construction, although it is not yet clear whether they will prove effective. As a consequence of a combination of high house prices and the widespread and growing use of variable-rate mortgages, households are particularly exposed to interest rate changes. The stock of UK corporate debt is modestly high yet some firms are having difficulty accessing adequate funding for investment. The UK is also confronted with the twin challenge of sustaining the pre-crisis dynamism in service exports and boosting the underlying drivers of productivity in the industrial sectors in order to regain the external competitiveness that was partly eroded in the pre-crisis years. The net trade outturn for 2012 was lower than expected. Overall public investment remains low and it is not clear when and to what extent private investment will pick-up. On current policies, the flow of credit may only be normalised once broader macroeconomic conditions improve. Skill gaps persist and closing them will require a substantial long-term investment. Given the size of the British economy, the imbalances may generate spill-overs to the other European economies.

4. CONCLUSIONS

The Commission's analysis leads it to conclude that in **Slovenia**, while in a still manageable position, **excessive macroeconomic imbalances are quickly building up**. Slovenia should now proceed swiftly and decisively by completing the reforms it has started and include comprehensive and detailed policy measures in its forthcoming National Reform Programme and Stability Programme, in order to halt and reverse this trend.

The Commission's analysis leads it to conclude that, despite significant progress in 2012, **Spain still has excessive macroeconomic imbalances.** Spain should maintain the reform momentum by including comprehensive and detailed policy measures in its forthcoming National Reform Programme and Stability Programme.

The Commission is ready to cooperate closely and swiftly with these two Member States in preparing this response, in full respect of national processes and with an appropriate involvement of domestic stakeholders. These policy packages will be assessed in May by the Commission as part of the European Semester to determine whether they are adequate in view of the challenges. Based on this assessment, the Commission will consider whether further steps are needed under the Excessive Imbalance Procedure.

The Commission also expects the eleven other Member States experiencing imbalances that are not found to be excessive, namely **Belgium, Bulgaria, Denmark, France, Italy, Hungary, Malta, the Netherlands, Finland, Sweden** and **the United Kingdom**, to take the findings of the in-depth reviews into account in their National Reform Programmes and Stability and Convergence Programmes. On this basis and in the context of the European Semester, on 29 May the Commission will make policy recommendations for the correction of these imbalances and the prevention of new ones.

On 29 May, on the basis of actual data for 2012 validated by Eurostat and the Commission services' Spring 2013 Forecast, the Commission will also reassess the situation under the on-going excessive deficit procedures and, where necessary, adopt the appropriate recommendations to the Council.

Annex: **Macroeconomic Imbalance Procedure-2013**

AMR-2013. On 28 November 2012, the European Commission presented the second Alert Mechanism Report (AMR-2013)[9], prepared in accordance with Regulation No 1176/2011. The AMR serves as the initial screening tool to identify Member States that warrant further analysis to determine whether imbalances, or excessive imbalances, exist[10]. The AMR-2013 examined the situation of all Member States, with the exception of the four countries which are implementing a wide range of reforms under economic adjustment programmes (Greece, Ireland, Portugal and Romania)[11]. It concluded that IDRs were warranted for Belgium, Bulgaria, Denmark, Spain, France, Italy, Cyprus, Hungary, Malta, the Netherlands, Slovenia, Finland, Sweden and the United Kingdom. These are the same twelve Member States for which in the previous cycle imbalances were identified in May 2012[12], plus Malta and the Netherlands. Although the AMR-2013 concluded that there was no need of carrying out IDRs for the other Member States, the Commission will put forward country-specific recommendations to all Member States under the European Semester for strengthened coordination of economic and budgetary policies[13].

In-depth reviews (IDRs). The IDRs examine macroeconomic developments with the aim of identifying imbalances, their origin, nature and severity, and in particular whether those imbalances are excessive in the sense of the MIP regulation. The IDRs cover a broad set of issues which demonstrate deeper surveillance of macroeconomic developments at EU level with the aim of supporting a smooth correction of existing imbalances and preventing the build-up of new ones. They consider a wide set of available statistics and other information and take into account methodological work by the Commission services in collaboration with the Member States[14]. In the preparation of the IDRs and of this Communications, specific surveillance missions, including discussions with the Member States and other stakeholders, took place, as envisaged in the legislation.

Policy recommendations and follow-up. Based on the IDRs, and on its assessment of the National Reform Programmes and Stability or Convergence Programmes to be submitted by 30 April, the Commission will on 29 May propose policy recommendations to be adopted by the Council. For the Member States experiencing imbalances, these recommendations (under the preventive arm of the MIP) are part of the integrated macroeconomic surveillance in the European Semester. If for the Member States with excessive imbalances, the Commission

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9 COM(2012) 751 final.

10 According to the MIP Regulation (Article 2(1, 2)), imbalances are trends giving rise to macroeconomic developments which are adversely affecting, or have the potential adversely to affect, the proper functioning of the economy of a Member State or of the economic and monetary union, or of the Union as a whole; excessive imbalances are severe imbalances, including those that jeopardise or risk jeopardising the proper functioning of the economic and monetary union.

11 For Greece, Ireland, Portugal and Romania, see the latest compliance reports, *European Economy-Occasional Papers*, 123, 127, 124 and 116, respectively.

12 See *European Economy-Occasional Papers*, 99 to 110, and Commission Communication 'Action for Stability, Growth and Jobs,' COM(2012) 299 final, 30.5.2012.

13 For the rationale of the MIP and a detailed description of the procedure, see 'The Surveillance of Macroeconomic Imbalances in the Euro Area,' *Quarterly Report on the Euro Area*, 1(2012):7-15.

14 Methodological work has focused on external imbalances, including on current account surpluses (see *e.g.* 'Current Account Surpluses in the EU,' *European Economy*, 9(2012)), price and non-price competitiveness, external sustainability (see *e.g.* 'The Dynamics of International Investment Positions,' *Quarterly Report on the Euro Area*, 3(2012):7-19), trade ('A Closer Look at Some Drivers of the Trade Performance at Member State Level,' *Quarterly Report on the Euro Area*, 2(2012):29-39), wage norms (see *e.g.* 'Labour Market Developments in Europe-2012,' *European Economy*, 5(2012)), housing prices (see *e.g.* 'Assessing the Dynamics in House Prices in the Euro Area,' *Quarterly Report on the Euro Area*, 4(2012):7-18), private sector indebtedness and deleveraging (see *e.g.* 'Indebtedness, Deleveraging Dynamics and Macroeconomic Adjustment,' *European Economy-Economic Papers*, 477 *forthcoming* 2013)).

then judges the policy response to be not adequate, the Commission would recommend to the Council to recommend that the Member States concerned take corrective action. The Member States concerned should then submit a corrective action plan (CAP) under the corrective arm of the MIP. The CAP will then be assessed by the Commission and the Council, and its implementation will be closely monitored by the Commission, with regular reports made public by the Member States concerned and the Commission.