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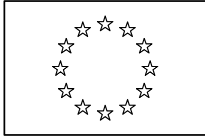

EUROPEAN COMMISSION

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REPORT FROM THE COMMISSION

Alert Mechanism Report

Report prepared in accordance with Articles 3 and 4 of the Regulation on the prevention and correction of macro-economic imbalances

1. INTRODUCTION

A new departure that widens and deepens economic governance in EMU

Large and persistent macroeconomic imbalances - reflected in large and persistent external deficits and surpluses, sustained losses in competitiveness, the build up of indebtedness and housing market bubbles – accumulated over the past decade and were part of the root causes of the current economic crisis. They not only caused macroeconomic difficulties for the Member States concerned, but also serious spillovers which contribute to the threats facing the euro area.

This Alert Mechanism Report (AMR) marks the first step in implementing the new surveillance procedure for the prevention and correction of macroeconomic imbalances (hereafter called the Macroeconomic Imbalance Procedure – MIP). This report also contains the final design of the scoreboard of indicators (presented in Table 1 and Section 2). Surveillance to prevent and correct macroeconomic imbalances under the MIP is a new instrument of the strengthened framework for economic governance in the EU. It was adopted as part of the so-called 'six-pack' governance package which *inter alia* also provides for a significant reinforcement of surveillance on fiscal policies. Surveillance on macroeconomic imbalances under the MIP forms part of the "European semester" which takes an integrated and forward looking approach to the economic policy challenges facing the Union in ensuring fiscal sustainability, competitiveness, financial market stability and economic growth.

The role and scope of the Alert Mechanism Report

The role of the AMR is to work as an initial screening device where the Commission identifies Member States where it considers that developments warrant further in-depth analysis to determine whether imbalances[1] exist or risk emerging. It should be emphasised that it is in the following in-depth studies that the driving forces behind the observed developments are analysed in detail with a view to determining the nature of the imbalances. Only on the basis of such in-depth analysis and, if appropriate, the Commission will propose policy recommendations, either under the preventive or the corrective arm of the procedure. The in-depth studies and the proposals for recommendations will be part of the European semester.

The need for further analysis is based on an assessment of a scoreboard of indicators established by the Commission after consultation with the Council, the European Parliament and the European Systemic Risk Board (see Section 2 and Tables 1 and 2 below)[2]. It should be emphasised that the scoreboard indicators are not mechanically interpreted. Countries are assessed by looking at the evolution of indicators over time as well as taking into account the most recent developments and outlook. In addition, the assessment takes into account a combination of additional relevant information. Also, the Commission pays particular attention to a wider set of indicators (see Section 2, Table 3), which the Council and European Parliament stressed as being of particular relevance in an economic reading of the scoreboard.

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1 The definition of imbalances is found in Article 2 in the regulation on the prevention and correction of macroeconomic imbalances.

2 The Council endorsed the scoreboard in the conclusions of the ECOFIN Council of 7 November 2011. The European Parliament adopted a resolution on 15 December 2011. The ESRB responded in a letter dated 9 December 2011.

Section 2 presents the design of the alert mechanism scoreboard. Section 3 makes a horizontal and thematic reading of the situation based on a reading of the scoreboard. In section 4 the analysis of the scoreboard is made per country. Section 5 provides main findings and conclusions.

Table 1. Scoreboard indicators and indicative thresholds (*)

	External imbalances and competitiveness					Internal imbalances				
Indicator	3 year average of **current account balance** as a % of GDP	**Net International Investment Position** as a % of GDP	% change (3 years) of **Real Effective Exchange Rate,** HICP deflators relative to 35 industrial countries (a)	% change (5 years) in **export market shares**	% change (3 years) in **nominal unit labour cost** (b)	y-o-y % change in **deflated house prices** (c)	**private sector credit flow** as % of GDP (d), (e)	**private sector debt** as % of GDP (d), (e)	**general government debt** as % of GDP (f)	3 year average of **unemploy-ment rate**
Data source	Balance of Payments statistics EUROSTAT.	Balance of Payments Statistics, EUROSTAT.	DG ECFIN indicator data base on Price and Cost competitiveness.	Balance of Payments statistics, EUROSTAT.	EUROSTAT	Harmonised house price index by EUROSTAT, completed with ECB, OECD and BIS data.	EUROSTAT for annual data and QSA, ECB for quarterly data.	EUROSTAT for annual data and QSA, ECB for quarterly data.	EUROSTAT (EDP – treaty definition).	EUROSTAT
Indicative thresholds	*+6/-4%*	*-35%* Lower quartile	*+/-5% for €A* *+/-11% non€A* Lower and Upper Quartiles of EA -/+ s.d. of EA	*-6%* Lower quartile	*+9% €A* *+12% non-€A* Upper Quartile €A3 p.p	*+6%* Upper quartile	*+15%* Upper Quartile	*160%* Upper Quartile	*+60%*	+10%
Period for calcu-lating thresholds	1970-2007	First available year (mid-1990s)-2007	1995-2007	1995-2007	1995-2007		1995-2007	1994-2007		1994-2007
Some additi-onal indicators to be used in economic reading	*Net lending/borrowing vis-à-vis ROW (Capital Account + Current Account balances as % of GDP)*	*Net External Debt as % GDP*	*REER vis-à-vis rest of the euro area*	*Export market shares based on volumes of goods; Labour productivity; Trend TFP growth*	*Nominal ULCs (changes over 1, 5, 10 years); Effective ULC relative to rest of euro-area Other measures of productivity*	*Real house price (changes over 3 years); Nominal house price (changes over 1 and 3 years) Residential construction*	*Indicator on change in financial liabilities of the non-consolidated financial sector and the debt over equity ratio*	*Private sector debt based on consolidated data*		

Notes: (a) for EU trading partners HICP is used while for non-EU trading partners, the deflator is based on a CPI close to the HICP in methodology; (b) index providing ratio of nominal compensation per employee to real GDP per person employed; (c) changes in house prices relative to the consumption deflator of EUROSTAT; (d) private sector is defined as non-financial corporations; households and non-profit institutions serving households; (e) sum of Loans, and Securities other than shares; liabilities, non –consolidated; (f) the sustainability of public finances will *not* be assessed in the context of the MIP given that this issue is already covered by the SGP. However this indicator is part of the scoreboard because public indebtedness contributes to total indebtedness of the country and therefore to the overall vulnerability of the country. (*) It is envisaged to develop a wider indicator of the banking/financial sector by the end of 2012.

Table 2: The MIP scoreboard for 2010

Year 2010	External imbalances and competitiveness					Internal imbalances				
	3 year average of **Current Account Balance** as % of GDP	**Net International Investment Position** as % of GDP	% Change (3 years) of **Real Effective Exchange Rate with HIPC deflators**	% Change (5 years) in **Export Market Shares**	% Change (3 years) in **Nominal ULC**	% y-o-y change in deflated **House Prices**	**Private Sector Credit Flow** as % of GDP	**Private Sector Debt** as % of GDP	**Public Sector Debt** as % of GDP	3 year average of **Unemployment**
Thresholds	**-4/+6%**	**-35%**	**±5% & ±11%**	**-6%**	**+9% & +12%**	**+6%**	**15%**	**160%**	**60%**	**10%**
BE	-0.6	77.8	1.3	-15.4	8.5	0.4	13.1	233	96	7.7
BG	-11.1	-97.7	10.4	15.8	27.8	-11.1	-0.2	169	16	7.5
CZ	-2.5	-49.0	12.7	12.3	5.1	-3.4	1.7	77	38	6.1
DK	3.9	10.3	0.9	-15.3	11.0	0.5	5.8	244	43	5.6
DE	5.9	38.4	-2.9	-8.3	6.6	-1.0	3.1	128	83	7.5
EE	-0.8	-72.8	5.9	-0.9	9.3	-2.1	-8.6	176	7	12.0
IE	-2.7	-90.9	-5.0	-12.8	-2.3	-10.5	-4.5	341	93	10.6
EL	-12.1	-92.5	3.9	-20.0	12.8	-6.8	-0.7	124	145	9.9
ES	-6.5	-89.5	0.6	-11.6	3.3	-3.8	1.4	227	61	16.5
FR	-1.7	-10.0	-1.4	-19.4	7.2	5.1	2.4	160	82	9.0
IT	-2.8	-23.9	-1.0	-19.0	7.8	-1.4	3.6	126	118	7.6
CY	-12.1	-43.4	0.8	-19.4	7.2	-6.6	30.5	289	62	5.1
LV	-0.5	-80.2	8.5	14.0	-0.1	-3.9	-8.8	141	45	14.3
LT	-2.3	-55.9	9.1	13.9	0.8	-8.7	-5.3	81	38	12.5
LU	6.4	96.5	1.9	3.2	17.3	3.0	-41.8	254	19	4.9
HU	-2.1	-112.5	-0.5	1.4	3.9	-6.7	-18.7	155	81	9.7
MT	-5.4	9.2	-0.6	6.9	7.7	-1.6	6.9	212	69	6.6
NL	5.0	28.0	-1.0	-8.1	7.4	-3.0	-0.7	223	63	3.8
AT	3.5	-9.8	-1.3	-14.8	8.9	-1.5	6.4	166	72	4.3
PL	-5.0	-64.0	-0.5	20.1	12.3	-6.1	3.8	74	55	8.3
PT	-11.2	-107.5	-2.4	-8.6	5.1	0.1	3.3	249	93	10.4
RO	-6.6	-64.2	-10.4	21.4	22.1	-12.1	1.7	78	31	6.6
SI	-3.0	-35.7	2.3	-5.9	15.7	0.7	1.8	129	39	5.9
SK	-4.1	-66.2	12.1	32.6	10.1	-4.9	3.3	69	41	12.0
FI	2.1	9.9	0.3	-18.7	12.3	6.8	6.8	178	48	7.7
SE	7.5	-6.7	-2.5	-11.1	6.0	6.3	2.6	237	40	7.6
UK	-2.1	-23.8	-19.7	-24.3	11.3	3.4	3.3	212	80	7.0

Note: (1) Cut-off date 30 January 2012; * Programme countries (IE, EL, PT, RO). LV ended its BoP assistance programme on 19 January 2012 but remains under post-programme surveillance.

Table 3: Additional indicators used in the economic reading of the MIP scoreboard, 2010

Year 2010	% y-o-y **growth of real GDP**	**Gross fixed capital formation** as % GDP	**Gross domestic expenditure on R&D** as % GDP	**Current Account balance** as % of GDP, BoP data	**Net lending / borrowing** vs. ROW as % GDP, BoP data	**Net external debt** as % GDP	**FDI Inflows** as % GDP	**Net Trade Balance** of energy products as % GDP	% Change (3 years) in **REER vs. EA (17)**	% y-o-y change in **Export Market Shares**, volumes	% y-o-y growth of **Labour Productivity**	% y-o-y growth of **Employ-ment**	% Change (10 years) in **Nominal ULC**	% Change (10 years) in **Effective ULC vs. EA (17)**	% Change (3 years) in **Nominal house Prices**	**Residential Construction** as % GDP	**Private Sector Debt** as % GDP, consolidated data	**Financial Liabilities of fin.sector**, non-consolidated y-o-y growth
BE	2.3	20.2	2.0	1.5	1.3	-121.8	5.7	na	1.9	-5.6	1.4	0.8	22.5	4.0	6.3	na	130.6	-2.1
BG	0.2	23.5	0.6	-1.3	-0.5	43.6	4.9	-5.9	:	3.9	6.4	-5.9	72.9	:	-11.8	4.3	151.2	-2.2
CZ	2.7	24.4	1.6	-3.1	-2.2	0.5	3.4	-3.5	:	3.0	4.5	-0.9	27.1	:	4.0	4.4	71.6	2.5
DK	1.3	17.2	3.1	5.5	5.6	25.4	-2.4	1.1	:	-10.4	3.6	-2.0	34.5	:	-14.1	4.2	244.1	7.8
DE	3.7	17.5	2.8	5.7	5.7	-5.8	1.4	-2.9	-1.4	-0.7	3.2	0.5	4.3	-16.7	3.6	5.3	111.8	0.0
EE	2.3	18.8	1.6	3.6	7.2	24.1	8.1	-1.5	8.0	7.7	7.4	-4.1	73.8	42.4	-44.5	3.3	na	-10.1
IE	-0.4	11.5	1.8	0.5	0.1	-295.9	12.7	na	-5.2	-12.4	4.0	-4.2	28.7	9.4	-33.8	3.0	292.8	5.9
EL	-3.5	16.6	na	-10.1	-9.2	97.4	0.1	-4.2	5.1	-11.7	-1.7	-1.9	36.6	13.7	2.8	4.8	124.1	8.5
ES	-0.1	22.9	1.4	-4.6	-4.0	91.7	1.8	-3.0	1.0	-6.8	2.6	-2.3	29.2	8.5	-9.9	7.5	213.9	-1.8
FR	1.5	19.3	2.3	-1.7	-1.7	23.5	1.3	-2.4	-0.1	-6.0	1.4	0.2	22.6	3.7	0.0	6.1	137.4	2.9
IT	1.5	19.7	1.3	-3.5	-3.5	51.3	0.4	-3.4	0.8	-4.7	2.3	-0.7	30.5	11.5	2.3	5.3	125.4	1.4
CY	1.1	18.6	0.5	-9.9	-9.7	18.4	3.3	na	0.6	-5.8	1.1	0.0	32.8	9.2	-6.5	6.0	289.0	-7.6
LV	-0.3	19.5	0.6	3.0	4.9	53.5	1.6	-4.8	:	2.9	4.7	-3.7	86.0	:	-46.8	2.0	135.8	-0.1
LT	1.4	16.3	0.8	1.5	4.2	39.4	2.1	-7.2	:	2.5	6.9	-5.2	28.6	:	-32.9	1.9	76.7	0.0
LU	2.7	18.4	1.6	7.7	7.1	-3312.0	386.0	na	1.8	-18.8	0.8	1.7	37.5	16.6	5.0	3.4	201.6	10.0
HU	1.3	18.0	1.2	1.1	2.9	60.3	1.4	-5.0	:	-2.9	0.9	0.0	53.7	:	1.4	2.5	134.8	3.2
MT	2.9	17.7	0.6	-3.9	-2.2	-176.2	12.8	na	3.6	-2.0	0.6	2.2	32.9	11.2	7.4	2.8	164.7	18.5
NL	1.7	18.2	1.8	6.6	5.8	30.7	-1.7	-2.9	-0.9	-4.6	2.2	-0.3	24.2	6.8	-3.8	5.0	222.0	7.0
AT	2.3	20.5	2.8	3.0	3.1	30.2	1.0	-3.0	0.2	-1.2	1.7	0.9	13.2	-2.8	5.6	4.2	149.7	-1.5
PL	3.9	19.9	0.7	-4.6	-2.8	33.5	1.9	na	:	-3.8	3.5	0.6	12.8	:	na	2.6	71.1	13.5
PT	1.4	19.8	1.6	-10.0	-8.9	84.4	0.6	na	-2.1	-8.8	3.0	-1.5	24.9	4.8	6.3	3.8	224.4	10.2
RO	-1.6	24.0	0.5	-4.0	-3.7	38.3	1.8	-2.2	:	2.4	0.2	-1.8	225.5	:	na	na	76.7	4.5
SI	1.4	21.6	2.1	-0.8	-0.8	31.7	0.8	-5.1	3.3	-2.3	4.0	-1.7	52.2	30.4	-2.6	3.2	118.4	-3.4
SK	4.2	22.2	0.6	-3.5	-1.9	23.9	0.6	na	12.8	2.4	5.7	-2.0	33.9	15.7	-1.2	2.7	69.0	1.6
FI	3.6	18.8	3.9	1.8	1.9	28.5	2.9	-2.9	2.1	-8.0	5.1	-1.5	21.8	3.2	8.9	6.5	155.0	19.0
SE	5.6	17.8	3.4	6.7	6.5	62.3	-0.3	-1.7	:	-0.7	4.4	1.1	15.6	:	13.3	3.2	221.0	2.1
UK	2.1	14.9	1.8	-3.3	-3.1	46.3	2.2	na	:	-5.7	1.9	0.3	30.0	:	-2.1	3.1	na	8.0

Note: (1) 'na' refers to data not available for the moment. (2) Cut-off date is 30 January 2012; * Programme countries (IE, EL, PT, RO). LV ended its BoP assistance programme on 19 January 2012.

2. THE DESIGN OF THE SCOREBOARD

The scoreboard has been established by the Commission in line with Article 4 of the Regulation[3] and after taking on board comments[4] from the European Parliament[5], the Council[6] as well as from the European Systemic Risk Board as regards financial market stability related issues[7]. The scoreboard indicators (see table 1) are publicly available[8].

When selecting the indicators and thresholds for this first edition of the scoreboard, the Commission has followed the guiding principles provided by the legislation. The scoreboard contains a small number of relevant, practical, simple, measurable, and available indicators. EUROSTAT sources are used when available, else the highest quality alternative data source has been chosen (e.g. the ECB). The selection of indicators is intended to allow for the early identification of imbalances that emerge over both the short-term as well as imbalances that arise due to structural and long-term trends. To this end the choice of indicators focuses on the most relevant dimensions of macroeconomic imbalances and competitiveness losses, with a particular emphasis on the smooth functioning of the euro area. It should be underlined that the surveillance of public debt is limited to its contribution to macroeconomic imbalances as the sustainability of public finances is already covered by the Stability and Growth Pact[9].

Indicative thresholds have been set at prudent levels a view to avoid excessive numbers of 'false alarms' but which are not set so stringently that they only identify problems once they are entrenched. Table 2 shows the values of the scoreboard indicators. They are based on data until 2010 which is the last complete year with data currently available. The shaded areas mark where the indicator value surpasses the identified indicative thresholds. These thresholds are the same for all countries (except for indicators on Real Effective Exchange Rates and Unit Labour Costs where a differentiation has been made between euro-area and non-euro-area countries). Moreover, the assessment also takes into account the most recent data as well as the economic outlook in the Commission's Autumn forecast published on 10 November 2011. Values of indicators for previous years and the most recent period are reported in the accompanying Statistical Annex[10].

The assessment of imbalances does not derive from a mechanical application of the scoreboard indicators and the related thresholds. It is the outcome of an economic reading of the scoreboard complemented by additional information and indicators taking due account of country-specific circumstances and institutions. In its Resolution[11], the European Parliament highlighted the need to adopt a comprehensive approach reflecting the productivity drivers

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3 Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances.

4 The Commission Staff Working Paper including the proposal for the envisaged scoreboard on which the consultation took place can be found at: WEBLINK. Moreover, the Commission will publish a background paper with additional evidence on the rationale and properties of the chosen indicators.

5 Resolution of the European Parliament adopted on 15 December 2011: http://ec.europa.eu/dgs/economy_finance/index_en.htm

6 Conclusions of the ECOFIN Council of 8 November 2011; http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/125976.pdf

7 The views of the ESRB on the envisaged scoreboard indicators relevant for financial market stability: http://ec.europa.eu/dgs/economy_finance/index_en.htm

8 http://ec.europa.eu/dgs/economy_finance/index_en.htm

9 Moreover, the indicator on the evolution of unemployment is read in conjunction with other, more forward-looking, scoreboard indicators and is used to better understand the potential severity of macroeconomic imbalances in terms of their likely persistence and the capacity of the economy to adjust.

10 http://ec.europa.eu/dgs/economy_finance/index_en.htm

11 See footnote 7.

and the unemployment trends. The European Parliament also recommended giving full consideration to spill over effects in the scoreboard analysis. To this end, and in line with the regulation, additional indicators are considered and which are presented in Table 3. This *inter alia* includes additional aspects linked to the general macroeconomic situation (including growth conditions and investments) nominal and real convergence inside and outside the euro area including additional aspects of trade performance and specificities of catching-up economies (including FDI and net external debt indicators). They also reflect the potential for the development of imbalances as well as the adjustment capacity of an economy such as productivity. As recommended by the Council, the European Parliament and the ESRB in their comments on the Commission proposal for the scoreboard, it also includes the state of financial markets, which played an important role in the current crisis[12]. This set of additional indicators is an integral part of the economic reading of the scoreboard and the related selection of Member States for which further investigation through in-depth reviews appears warranted.

3. A THEMATIC READING OF THE SCOREBOARD

Current account divergences have narrowed but not disappeared with the crises…

The large contraction in economic activity during the crisis resulted in a significant reduction in external imbalances. In particular, Member States which entered the recession with large current account deficits have experienced pronounced corrections on the back of a sharper drop in private sector demand and a corresponding contraction in imports. At the same time, several Member States with large current account surpluses have recently been experiencing relatively more resilient, albeit not very dynamic, private sector demand and/or their exports have been held back by the slump in world demand, which contributed to some reductions in current account surpluses.

Nevertheless, high current account deficits and surpluses have not vanished altogether. The scoreboard indicator on the current account balance (3-year average of current account balances as a % of GDP) still indicates deficits exceeding the indicative threshold of 4% of GDP in Bulgaria, Spain, Cyprus, Malta, Poland and Slovakia, even though in some of these Member States the current account deficit has continued declining in the most recent period.

The potential vulnerability from external deficits can be reduced if these are financed through relatively safe means such as FDI or capital transfers. FDI inflows were high before the crisis in many of the catching-up Member States: over the last five years, for example, FDI inflows covered more than half of current account deficits in Bulgaria, the Czech Republic, Estonia, Malta and Slovakia. Similarly, the positive balance on the capital account, where the capital transfers from abroad are typically recorded, has been non-negligible in a majority of catching-up Member States[13].

[12] It should be noted that some of the scoreboard indicators, notably on credit developments and house prices, also reflect this aspect. It is envisaged to develop an indicator on banking/financial sector by the end of 2012 to be included in the scoreboard of the and in time for the subsequent European semester.

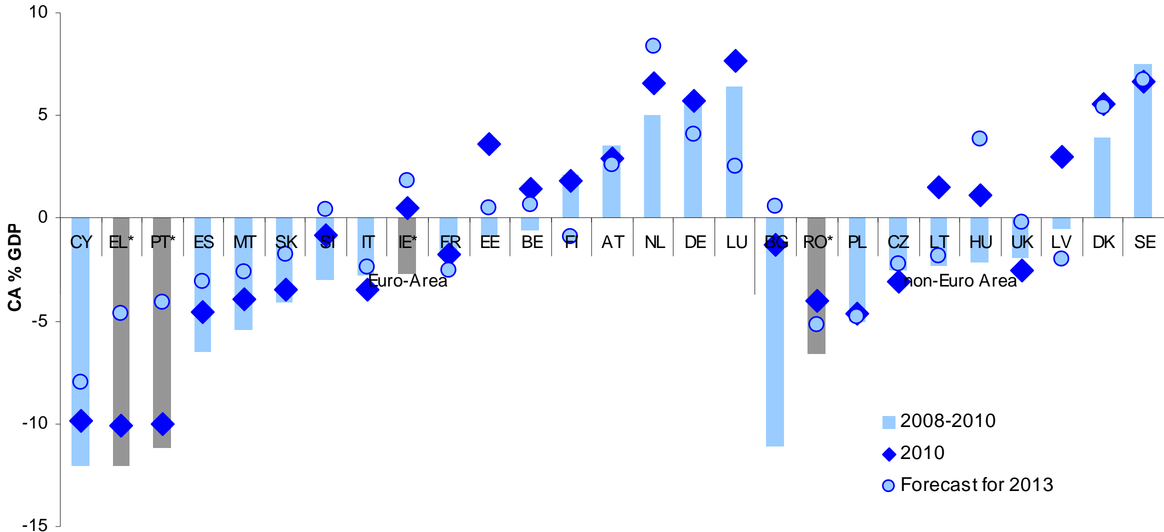
[13] These transfers also include capital inflows from EU structural funds. In the cases of Slovakia and Poland, including the capital account balance would actually bring the indicator value inside the limits of the indicative thresholds. Also Greece, Spain and Portugal benefited from strong inflows from EU structural funds.

On the other hand, some Member States continue to record persistent current account surpluses: Luxembourg and Sweden exceed the indicative threshold of 6%, while Germany and the Netherlands are just below it.

The Commission's 2011 autumn forecast points to some further narrowing of current account positions over next two years, although the reductions in deficits are likely to be mild in most cases, while in the Netherlands, for example, surpluses are set to increase (see graph 1).

On the way forward, a key issue is whether current account imbalances will stay moderate or increase again once conditions in markets improve. Some of the past imbalances were driven by excessive demand growth fuelled by overly optimistic expectations about future income growth in some Member States. To the extent the recent corrections reflect reassessment of such expectations rather than purely cyclical drops in output, they could prove sustainable. On the other hand, adjustments in relative prices have been limited in most cases, which eventually leaves the question about the structural nature of these realignments and hence their sustainability open.

Graph 1: Current account balances as % of GDP



Note: Forecast figures are corrected for the level differences between Balance of Payments and National Accounts (Rest of the World) data; programme countries are in grey and marked with an asterisk.

Source: European Commission.

…and the stocks of net external liabilities remain substantial in many cases.

The net international investment positions (NIIP)[14] as a share of GDP have stayed at high negative levels in many current account deficit countries. This is due to persistent, although lower, current account deficits and also weak growth dynamics. Currently, the NIIP positions exceed the indicative threshold of -35% in a number of Member States: Bulgaria, the Czech Republic, Estonia, Spain, Hungary, Latvia, Lithuania, Slovakia, Poland, and by small margin in Slovenia. The degree of vulnerability is lower if the share of liabilities that require repayment of principal or interest, such as loans or portfolio debt, is low. An indicator of net

[14] Net International Investment Position statistics record the net financial position (liabilities minus assets) of a country vis-à-vis the rest of the world. Data cover stocks of direct and portfolio investments, financial derivatives and other investment and reserve assets.

external debt[15] (NED, see table 3) shows that such liabilities are relatively low in many catching-up Member States, largely due to the high levels of FDI stocks. On the other hand, they are rather high in Spain, Hungary, Lithuania and Latvia.

The pre-crisis developments in external positions coincided with price competitiveness divergences …

Member States with high and persistent current account deficits accumulated losses in measures of price and cost competitiveness in the years preceding the crisis. Wage growth tended to outstrip productivity improvements in many EU countries, inducing increases in unit labour costs (ULC). Similarly, the developments in real effective exchange rates (REER), which show price competitiveness relative to the main trading partners, painted a picture of increasing divergence. This may signal overheating, potential structural rigidities in product and labour markets and/or inappropriate responses of wages to country-specific shocks, but could also reflect a catching-up process in some Member States. In a number of Member States with high external deficits, the increases in labour costs were concentrated, although not exclusively, in the non-tradable sectors. This, in turn, induced a reallocation of resources towards these sectors, exerting further pressure on external positions.

The crisis has interrupted these developments and initiated adjustment[16]. The scoreboard indicator (3-year change in the ULC index), nonetheless, shows that a number Member States still exceeded the indicative thresholds over the years 2008-2010 (9% for euro-area members and 12% for non-euro-area ones)[17], namely Bulgaria, Luxembourg, Poland, Slovenia, Slovakia and Finland. The indicator of REER developments (based on HICP deflators and showing 3-year percentage change) also shows interruptions or reversals of the pre-crisis trends. In Member States which exceed the indicative thresholds, the developments were mainly driven by changes in nominal exchange rates. This is true for Slovakia (before its entry in the euro area) and the Czech Republic which experienced sharp appreciations of their currencies. The UK experienced a significant depreciation. Conversely, Estonia's appreciation of its REER was largely driven by higher inflation compared to its trading partners, mainly due to a higher responsiveness of domestic inflation to increases in global commodity prices as well as to higher administered prices increases. Notwithstanding the often sizeable reversals, the long-run price competitiveness losses have not been fully corrected in most Member States. Further realignments in relative prices and improvements in competitiveness would facilitate the needed sectoral reallocation and contribute to the sustainability of the external adjustment.

[15] Net External Debt shows the net position of a country vis-à-vis the rest of the world as regards liabilities that require payments of principal and/or interest by the debtor at some point in the future. NED can be derived from the NIIP by excluding non-debt external liabilities (e.g. equity).

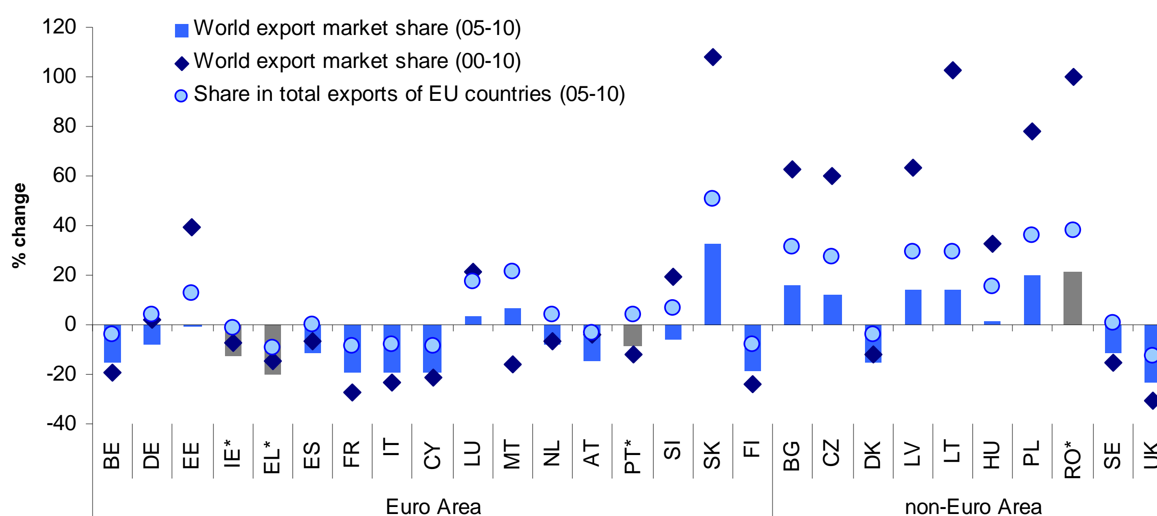
[16] In 2009, ULC growth accelerated because the large drops in productivity, due to output losses and labour hoarding, exceeded the often significant wage corrections. However, average growth of ULCs slowed down significantly in 2010 and has been moderate in 2011.

[17] In the scoreboard indicative thresholds can be differentiated between euro area and non-euro area Member States economically justified. As regards the ULC, the rationale for this differentiation is that the majority of non-euro area Member States, i.e. those who acceded in 2004 and later, have experienced trade liberalisations since early 1990s which has entailed a natural process of factor price convergence implying relatively stronger labour cost growth.

…while the EU as a whole has lost global export market shares, some Member States have lost more than others.

Changes in world export market shares of goods and services (percentage change over five years) point to potentially important structural losses in overall competitiveness in the global economy in a number of Member States. Belgium, Denmark, Germany, Spain, France, Italy, Cyprus, the Netherlands, Austria, Finland, Sweden and the UK have sustained market share loses exceeding the 6% indicative threshold. In a number of these countries, the losses in export market shares are even more pronounced if a longer time period is considered (see graph 2). In addition to losses in price/cost competitiveness, this may also reflect sluggish improvements in non-price competitiveness, low ability to exploit new sales opportunities or the diversion of resources to the non-tradable sector during domestic absorption booms. In many cases, these reductions in global export market shares are largely due to the fact that exports of these Member States grew at a lower pace than the world trade – the export share of the EU as a whole has declined. However, export performance of Belgium, Denmark, France, Italy, Cyprus, Austria, Finland and the UK has also been less dynamic compared to other EU countries as witnessed by the declining shares of their exports in total exports of all EU Member States (see graph 2)[18].

Graph 2: Percentage changes in export market shares.



Note: Programme countries are in grey and marked with an asterisk.

Source: European Commission.

Indebtedness weighs on households and corporations

The prolonged period of credit expansion prior to the crisis has left economic agents in many Member States with large levels of accumulated debt (see graph 3). This process partially reflected enhanced financial market integration and deepening, altogether with convergence in nominal interest rates. Moreover, rapid credit growth was also fuelled by other factors, such as misalignments in assets prices, exacerbated by favourable asset taxation and lending standards as confirmed by a generalised increase in the share of loans for house purchases over total loans in the run-up to the crisis. The indebtedness of the private sector as a whole exceeds the indicative threshold of 160% in more than a dozen Member States: Belgium,

[18] These conclusions seem to broadly hold also when looking at the change in export market shares based on volumes of goods trade.

Bulgaria, Denmark, Estonia, Spain, Cyprus, Luxembourg, Malta, the Netherlands, Austria, Finland, Sweden and the UK. A high level of private sector debt increases the exposure of the private sector to changes in the business cycle, inflation and interest rates. Moreover, the unwinding of excessively leveraged positions jeopardises growth and financial stability. At a disaggregated level, non-financial corporations were the primary drivers behind debt accumulation in Belgium, Spain, Cyprus, Slovenia and Sweden. While the ability of firms to repay their debt (debt over GDP or value added) can serve as a starting point for the analysis of corporate indebtedness, a closer look at the share of assets that are financed by debt and their maturity structure will qualify the actual needs for deleveraging as well as its speed. Furthermore, the household sector was largely responsible for the rise in leverage in Denmark, the Netherlands and the UK, with the household debt level exceeding their GDP levels. These developments came hand in hand with cumulated increases in house prices above 150% over the last cycle (only matched by house price hikes in Spain and Ireland).

Price increases in housing markets reached unprecedented levels.

Household indebtedness is closely linked with housing market developments: growth in credit to households and house price increases went hand in hand during the decade preceding the crisis. The house price cycle in the EU was particularly pronounced, with an average cumulated growth in prices of over 40%. For example, house prices more than doubled during the period of upswing in a half of the Member States. Moreover, in around two-thirds of Member States, the average pace of real house price increases exceeded 6% annually and in some cases the average annual growth rates were as high as 20% to 35%. While the length and the speed of this expansion has shown significant variations across countries, house prices peaked in a vast majority of Member States in 2007/2008. Expectations of continued house price increases also facilitated increases in size of the construction sector. Indeed, high residential investment went hand in hand with the increase in house prices for many Member States, like Denmark, Spain, Lithuania, Malta, Sweden and the United Kingdom.

… but adjustment is underway although it is unclear how far it will go and for how long it will continue.

A correction is now underway: real house price increases were below the indicative threshold of 6% in all Member States but Finland and Sweden in 2010. Recent adjustments have been rather significant and countries that experienced the highest and fastest increases in prices before the crises have tended to show, albeit not in all cases, the most pronounced corrections, signalling the existence of pre-crisis overvaluation. For example, Bulgaria, Denmark, Estonia, Spain, Lithuania, Latvia and Slovakia went through a significant adjustment following large accumulated real house prices rises. Notwithstanding these corrections, there might still be scope for further retrenchment in several countries which also experienced large and fast house price increases, such as Belgium, France, Luxembourg, Malta, Slovenia, Sweden and the United Kingdom, as there is typically a direct link between the strength of the correction phase and the amplitude of the boom phase of the house price cycle. In addition, worsening credit conditions and weak GDP growth are likely to weigh on housing prices developments in the near future. Supply conditions will prove an important factor as well.

Deleveraging has started …

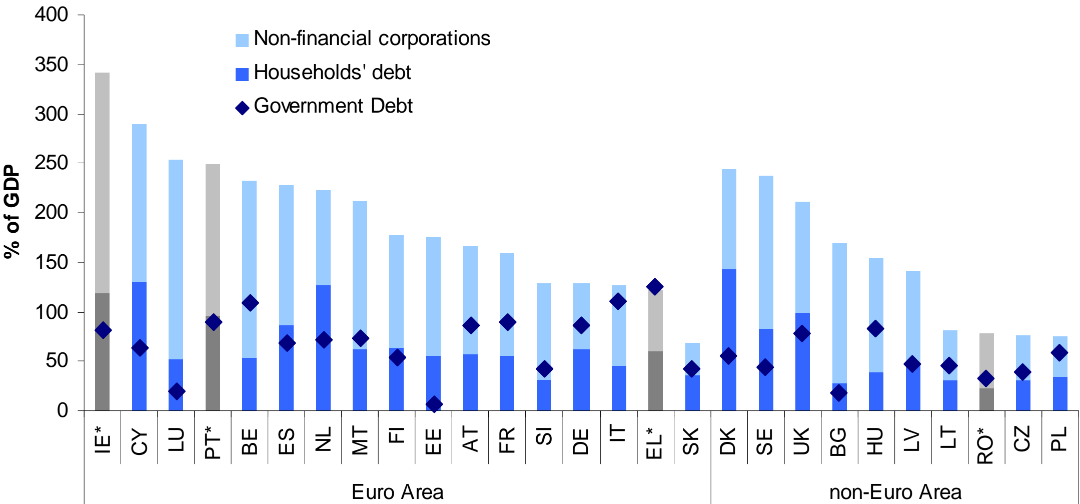
More generally, the supply of credit to the private sector slowed down drastically in some Member States and the deleveraging process has begun. The data on private credit flows show that the adjustment started in 2009, following a still-buoyant credit expansion in 2008. In

2010, credit growth exceeded the indicative threshold of 15% only in Cyprus. Slow credit growth combined with increased net savings may have a negative feed-back effect on GDP growth through a constrained internal demand. Empirical evidence shows that crisis-induced balance sheet adjustments in the private sector last on average more than five years, and even longer in the non-financial corporate sector. In this context, net exports and productivity developments are important as essential drivers of economic growth.

… making the EU economies more vulnerable.

In the course of the financial crisis, it has become clear that the overall indebtedness of a Member State is important and that there are strong linkages between private sector and general government debt[19]. Therefore, private sector debt needs to be considered together with general government debt because the impact of deleveraging in the private sector could be magnified by the on-going sovereign debt crisis exerting pressure on highly-indebted public sectors. This could particularly be the case for Member States characterised by highly indebted public and private sectors, e.g. Belgium[20] or the UK (see graph 3). While private sector indebtedness is not excessive in Italy, the high level of public debt and the need to consolidate public finances could exert pressures on private sector balance sheets. Elevated amounts of debt in the hands of non-residents can prove to be an additional concern in a context of high uncertainty in international financial markets as they increase the vulnerability of a country to shortages of capital or sudden stops in capital inflows. As regards external indebtedness, Spain and Hungary in particular feature a combination of high private and net external debt. Moreover, when denominated in a foreign currency, debt may raise additional vulnerability concerns arising from exchange rate fluctuations.

Graph 3: Levels of accumulated debt by sector as % of GDP (2010)



Note: Private debt is based on non-consolidated data.
Source: European Commission.

[19] Governments have taken on large contingent liabilities from the private sector which, even if they do not immediately impact on debt levels, may affect their perceived creditworthiness. There are also feedback effects from the private sector to the government sector, as private sector actors (not only financial institutions) may become large creditors to sovereigns, making them vulnerable to fiscal woes.

[20] Although the private sector debt based on consolidated figures is lower in Belgium due to a high share of intra-company loans.

The adjustment in the real economy is ongoing

The adjustment of external imbalances and the repair of household and corporate balance sheets have been rather painful, particularly in Member States which experienced large imbalances prior to the crisis. This adjustment has been largely driven by developments in domestic demand, and has often been associated with a significant rise in unemployment levels. This may reflect limited price/wage adjustment but could also reflect the ongoing process of sectoral reallocation. The adjustment to macroeconomic imbalances often requires shifts of labour and capital across different sectors in the economy, in particular from artificially inflated real estate sectors to tradable sectors. This process is usually gradual (given the different skill requirements of the sectors concerned) and has still some way to go.

Unemployment levels have been high over the past years and the scoreboard indicator (3-year average of unemployment rate) is above the indicative threshold of 10% in Estonia, Spain, Latvia, Lithuania and Slovakia. Also in many other Member States, this indicator pointed to rather high levels of unemployment, which, moreover, have generally followed an upward trend. The structural unemployment rate has been affected considerably by the recent recession. The reallocation of labour across the sectors in the economy has been sluggish in most Member States and the resulting high levels of unemployment involve potentially large losses in human capital and overall efficiency. Moreover, unemployment prospects are likely to be affected by the current uncertainty and fading growth momentum, the scope for sectoral reallocation in the economy and the ongoing deleveraging process in many Member States.

The adjustment is bound to be more challenging in the low productivity growth environment. The declining trend in productivity contributed to the accumulation of macroeconomic imbalances and competitiveness losses in the pre-crisis period in a number of Member States. At the same time, achieving the necessary adjustment in labour costs and relative prices is easier when productivity is increasing at a sustained pace as this reduces the pressure on changes in nominal wages and prices.

4. COUNTRY-SPECIFIC COMMENTARIES ON THE READING OF THE SCOREBOARD

The commentaries below do not cover Member States which are subject to surveillance under programmes. This concerns Greece, Ireland and Portugal in the euro-area and Romania outside the euro area.

Belgium: the value of scoreboard indicators for the change in export market shares, gross private sector debt and public sector debt are above the indicative thresholds. With respect to external competitiveness, there has been a loss in export market shares, going hand in hand with a deterioration in the current account balance even if the level remains below the indicative threshold and the deteriorating goods balance is partly being offset by the services balance performing well. These trends may be explained by declining cost competitiveness due to, inter alia, ULC increases that are higher than those of the euro area, but also to non-cost competitiveness. On the internal side, the private sector debt indicator is well above the relevant threshold. There are qualifications to take into account, including the impact of intercompany loans on non-financial corporate debt and that household debt is mostly mortgage related while the household savings rate remains high. Notwithstanding this, the level of gross private sector debt should be seen in conjunction with high levels of public debt.

Bulgaria: prior to the crisis, Bulgaria recorded large current account deficits, which has led to a NIIP in deficit, driven by capital inflows (mostly in the form of FDI) and private credit growth. The crisis resulted in a sharp correction of the current account deficit which is now projected to turn into a slight surplus in 2011 and subsequent years. The improvement came not only from reduced imports but also from a strong export performance in a catching-up context. Bulgaria shows one of the highest rises in ULC in the EU although the wage increases, from very low base level, are part of the ongoing convergence process but could slow the catching-up process over the medium and longer run. Private sector indebtedness has increased rapidly to levels above the indicative threshold mainly explained by increases in corporate debt while household debt remains limited as does public sector debt.

Czech Republic: current account deficits, albeit below the threshold, have been recorded over the last decade though some narrowing can be observed in recent years, driven largely by an improving trade balance. As a result NIIP surpassed the indicative threshold, although recent unfavourable valuation effects on the stocks of assets and liabilities should be acknowledged. Due to the predominant FDI financing and relatively contained private and public sector debt, the net external debt has remained close to zero. Despite losses in price competitiveness through strong REER appreciation and growth in ULCs, there have been gains in export market shares.

Denmark: the current account is recording continuous surpluses mainly thanks to strong services exports, revenues from oil and gas exports, and earnings on foreign investment. There have however been losses of export performance over the past years as witnessed by the indicator of export market shares being above the threshold. Moreover, Denmark price competitiveness has deteriorated somewhat due to high nominal wage agreements in a period of overheating and weak productivity growth. The Danish housing boom, which started to be corrected in 2007, was associated with rapid credit growth and a surge of private sector debt, in particular in the household sector. While credit and house prices have partially adjusted in recent years, the stock of private sector debt remains very high and above the indicative threshold although for households this partly reflects elevated contributions to private pension saving schemes and a generous safety net.

Germany: across the last decade Germany recorded persistent current account surpluses. This reflects in part an export performance coinciding with regained price competitiveness, and in part subdued domestic investment and relatively high household saving rates. However, in recent years, domestic demand has been slowly strengthening, supporting a gradual narrowing of the current account surplus, and can be seen as part of rebalancing. Further, while a loss of export market shares of goods has been recorded, this development is less marked than for the euro area average. On the internal side, private sector indebtedness is relatively contained while the indicator for general government debt exceeds the indicative threshold but it is projected to diminish in 2011 and the phasing in of the constitutional debt brake should underpin a trend decline.

Estonia: in the last decade, Estonia consistently recorded current account deficits, until a marked correction took place during the crisis; in the same period, it achieved large gains in export market shares, despite losses in price competitiveness (from a low initial price level). In recent years, there has been wage and cost adjustment. Overall, there has also been a gradual build up of a negative NIIP and it remains above the indicative threshold: however, this to a large extent reflects FDI implying that net external debt is substantially lower. Private sector indebtedness is above the indicative threshold, although the deleveraging process is strong. In combination with high nominal GDP growth the private sector debt ratio is set to

fall. Unemployment is high but adjusting quickly downwards reflecting high labour market flexibility.

Spain: the economy is currently going through an adjustment period, following the build-up of large external and internal imbalances during the extended housing and credit boom in the years prior to the crisis. The current account has shown significant deficits, which have started to decrease recently in the context of the severe economic slowdown and on the back of an improving export performance, but remain above the indicative threshold. Since 2008 losses in price and cost competitiveness have partially reversed. While the adjustment of imbalances is on-going, the absorption of the large stocks of internal and external debt and the reallocation of the resources freed from the construction sector will take time to restore more balanced conditions. The contraction in employment linked to the downsizing of the construction sector and the economic recession has been aggravated by a sluggish adjustment of wages, fuelling rising unemployment.

France: an economic reading of the scoreboard points to issues on both the external and internal sides. The contraction of France's market share in world exports is above the indicative threshold, and this decline is amongst the largest in the EU. There is a gradual deterioration of the trade balance, and this is reflected in a deterioration of the current account balance even if still below the indicative threshold. Concerns about the external position of the French economy are also fuelled by some losses in both price and non-price competiveness. In this context, the reduction in profitability of French companies and the implications for investments are relevant factors that deserve further analysis. The level of private sector indebtedness has gradually increased to reach the indicative threshold level, and this has occurred alongside higher levels of public sector debt.

Italy: scoreboard values are above the indicative thresholds in the areas of competitiveness and public debt. Italy has had a significant deterioration in competitiveness since the mid-1990s which is also seen through the persistent losses of market shares. These losses are only partly reflected in the steady worsening of Italy's external position, given the relatively subdued growth of domestic demand. Weak productivity developments are the main explanatory factor. While private sector indebtedness is relatively contained in Italy, largely thanks to the financial position of households, the level of public debt is a concern, especially given the weak growth performance and structural weaknesses. This, in turn, potentially puts strain on private sector balance sheets.

Cyprus: with the values of many indicators above indicative thresholds an economic reading of the scoreboard points to wide-ranging challenges as regards both the external and internal side. The Cypriot economy has been characterised by persistent current account deficits over the past decade mainly driven by buoyant domestic demand. The evolution of the Cypriot current account shows large disparities in the trade of goods and services reflecting a shift of the Cypriot economy towards the tertiary sector. The negative trade balance in goods is only partly compensated by the surplus recorded in services trade. Cyprus recorded price competitiveness losses in the years ahead of the crises but this trend has been more contained in latter years. The highly leveraged private sector has continued to unwind its large level of outstanding debt, which nevertheless coexists with substantial assets. The deterioration of the economic outlook and the fiscal situation as well as the implications from the exposure of the banking sector to Greece add to concerns on the challenges involved in adjusting to imbalances in other sectors of the economy.

Latvia: until 2008, Latvia recorded large and sustained current account deficits coupled with a rapid growth of a negative NIIP even though net external debt is lower taking FDI into account. The crisis brought a marked hard landing with an immediate and abrupt correction of the current account deficit requiring a strong adjustment programme supported by balance of payment assistance which is about to end in January 2012. The previous trend of continuous losses of price competitiveness has been compensated by internal adjustment including wage and employment cuts. The boom years were also characterised by strong credit growth, booming house prices and construction. This implied a rapid build up of private sector debt leading to a process of deleveraging and a substantial adjustment of house prices in the bust period. While unemployment is still high, it fell quickly from its peak in late 2009.

Lithuania: until 2008 Lithuania recorded large current account deficits as well as losses of price competitiveness, reflecting a domestic boom. As a result of a marked and significant adjustment process during the crisis years, the current account is now at levels closer to balance. The REER has depreciated, mostly as a result of nominal wage declines. Even before 2008 Lithuania was able to gain export market shares from a low level. While the NIIP remains negative and at high levels above the indicative threshold, net external debt is much lower taking financing through FDI into account. The financial crisis brought to an end the expansion of the banking sector and robust wage dynamics, private sector started to deleverage, credit flows as a percentage of GDP turned negative and house prices have corrected significantly. While unemployment is still high, it is falling from its peak in 2010.

Luxembourg: the value of the scoreboard indicator for the current account balance is above the threshold, caused by trade surpluses reflecting the country's strong specialisation in financial services. This, however, is not related to subdued domestic demand, but concentration of economic activities and jobs in the country. Luxembourg has lost price competitiveness as a result of high wage increases and low productivity growth, but it should be noted that at the same time Luxembourg is gaining export market shares in services. Private sector indebtedness is above the indicative threshold, coupled with large and volatile credit flows. This is mainly explained by lending and borrowing operations inside international non-financial corporations, rather than an excessive indebtedness of the private sector. The household debt level is relatively contained. Real house prices witnessed large cumulated growth during the last decade and the correction is limited so far.

Hungary: the values of scoreboard indicators for the public debt ratio and NIIP are well above the indicative thresholds. The latter is the result of the continuous current account deficits recorded in the years before the crisis. With the crisis a sharp adjustment has taken place as domestic demand collapsed but the NIIP deficit remains large even if a substantial part is financed by FDI. The pre-crises period also saw very strong credit growth, which in particular for households has been largely financed in foreign currency. The accumulation of external financial exposure in the private sector has taken place in a context of high and increasing public debt levels also financed in foreign currency. In November 2011, the government formally requested precautionary financial assistance from the EU and the IMF[21].

Malta: the economy experienced persistent current account deficits over the past decade but they have narrowed in recent years and Malta has a positive NIIP. It remains to be seen whether the narrowing of the external deficit is of a structural nature or not. Past export market share losses reflect the decline in traditional manufacturing activities but are being

[21] Formal negotiations have not yet started.

reversed by the services sector. On the domestic side, house prices have risen significantly but now appear to be on a downward path.

Netherlands: in the years leading up to the crisis, the Netherlands recorded persistent large current account surpluses, mainly driven by the trade balance, including the impact from positive net gas exports. The levels are however currently below the threshold even though they will increase in coming years according to the Commission forecast. Despite some rise in nominal unit labour costs, the losses in export market shares has been contained. The surpluses also reflect high saving in the corporate sector coupled with subdued investment. Internal risks to the economy in the Netherlands mainly relate to the relatively high private sector debt and real estate markets. In the years before the crisis, household debt relative to disposable income and house prices increased, partly related to fiscal incentives for households to take up large mortgages. At the same time, the net financial asset position of households is positive.

Austria: as regards the external performance Austria has recorded sustained current account surpluses. At the same time the indicator for export market shares point to losses although ULC growth has been contained Private sector debt levels have gradually been rising and are currently somewhat above the indicative threshold as is also public sector debt. However, Austria did not, in relative terms, experience a domestic housing, asset or credit boom in the late 2000s and the increase of indebtedness has been primarily driven by corporations. Recent developments for 2011 suggest that the rise in private indebtedness has come to a halt and that the private sector, including nonfinancial corporations, will be in a net lending position.

Poland: although the values of scoreboard indicators for the current account balance and NIIP are above the indicative thresholds, these need to seen in the context of a catching-up process and were largely financed through relatively stable FDI and EU funds inflows. There have been limited losses in price competitiveness in 2006-2008 driven by nominal exchange rate appreciation, but since 2009 the trend reversed. Despite these losses Poland experienced large gains in export market shares and limited increases in nominal ULC. There has been relatively strong credit growth and build up of private sector debt, albeit from a low level, but partially financed in foreign currency.

Slovenia: two indicators in the scoreboard exceed the threshold in 2010. In the years before the crisis, Slovenia enjoyed strong growth and domestic demand conditions, coupled with some losses in price competitiveness and a gradual widening of the current account deficit. There are signs that overheating occurred, particularly as regards private sector credit growth, construction value added and property prices. The Slovenian economy was hit hard by the global crisis. This has brought some, perhaps temporary, adjustment in the external balance but this is still at an early stage. The high indebtedness of non-financial corporations, including in the construction sector, is reflected in corporate bankruptcies, loan-to-equity ratios and loan arrears.

Slovakia: the current account for Slovakia recorded large and sustained deficits during the last decade, partially financed through capital transfers from abroad. Nevertheless, the current account indicator remains above the indicative threshold although marginally. Foreign direct investment, which was largely directed to productive export-oriented industries, accounted for a dominant share of the gradually deteriorating net international investment position. Loss in price competitiveness reflected in a value of the REER indicator that is above the indicative threshold is mainly due to a strong nominal appreciation, and came together with high growth

in productivity, exports and world shares of trade. Overall, public as well as private sector indebtedness levels remain low.

Finland: several scoreboard indicators relating to external positions, such as export market share losses, are above the indicative thresholds. The current account is in surplus, although declining, over the last decade reflecting the global slowdown but also structural changes in the export sectors. Moreover, while losses in price competitiveness were relatively contained over most of the past decade, in recent years there have been some sharper losses due to slow adjustment of wages in a context of falling productivity. The scoreboard also points to a steady increase in the level of private sector indebtedness during the last decade which is now above the indicative threshold, driven to a large extent driven by increasing mortgages. House prices increased over the last decade despite some moderate correction over 2008-2009. In 2010 prices started to pick-up again, and at a pace above the indicative threshold, although prices have moderated since the second half of 2011.

Sweden: there has been a record of persistently large current account surpluses, above the indicative threshold. This reflects positive private and public sector saving positions on the one hand but also to some extent subdued domestic investment, in particular in the construction sector. Indicators of cost developments such as unit labour costs and real effective exchange rates do not point to a loss in price competitiveness. At the internal side Sweden shows a very high level of private sector debt well above the indicative threshold. There has been increasing household indebtedness, which is now at high levels despite recent slower credit growth. This reflects very strong increase in house prices over the last fifteen years which have started to stabilise only recently.

UK: the UK has lost export market shares over the last decade, with the indicator being above the threshold, although some stabilisation can be noted in recent years. This loss of market shares has taken place despite a substantial depreciation of the REER in recent years. At the same time, the UK recorded current account deficits albeit below the indicative threshold. The high level of private debt is a concern also in a context of a weak public finance situation with high and increasing public debt. The household debt largely reflects mortgages in a context of high accumulated increases in house prices. While both the level of household debt and real house prices has been reduced, they still remain high which suggests that the unwinding of these imbalances has further to go where the speed of adjustment is an important aspect.

5. MAIN FINDINGS AND CONCLUSIONS

This first implementation of the macroeconomic imbalances procedure takes place against the background of a problematic economic environment dominated by concerns about sovereign debt. All Member States are adjusting to the impact of the crisis, although their individual challenges differ in terms of scope and severity. As the Commission's recent Annual Growth Survey[22] explains, in addition to correcting significant imbalances that built up over previous years, the Union and Member States are also dealing with the interrelated challenges of tackling low growth and high unemployment, ensuring sustainable public finances and restoring stability to the financial system. The objective to reduce imbalances is also recognised in the context of the G20 where a surveillance process to promote an orderly rebalancing of global growth conditions has been put in place.

[22] http://ec.europa.eu/commission_2010-2014/president/news/documents/pdf/ags_en.pdf

An adjustment of macroeconomic imbalances is underway in many Member States, especially those which have/had high external deficits and large imbalances in household and/or corporate balance sheets and in their public sectors. This process still has some way to go, and has led in a number of Member States to a significant rise in unemployment levels and a reduction in the level of economic activity in the short term. As highlighted in the Annual Growth Survey, reforms promoting productivity growth will have particular relevance for Member States suffering from macroeconomic imbalances due to their positive impact on potential output and adjustment capacity[23]. In the current environment, the risks of new demand-led imbalances emerging are generally low, although pressures on asset markets could re-emerge once growth resumes.

Given that programme countries are already under enhanced economic surveillance of their economic situation and policies, they are not examined under the macroeconomic imbalances procedure.[24] This concerns **Greece, Ireland, Portugal** and **Romania.** Latvia is under post-programme surveillance as the balance of payment assistance programme expired on 19 January 2012 and is therefore examined in this report.

On the basis of the economic reading of the scoreboard, the Commission considers that further in-depth analysis is warranted to closer examine issues involving several Member States. The broad approach reflects the fact that this is the first application of surveillance under this procedure and that it therefore has to cater also for the adjustment to previously accumulated imbalances. The Member States concerned are: **Belgium, Bulgaria, Denmark, Spain, France, Italy, Cyprus, Hungary, Slovenia, Finland, Sweden and the United Kingdom.**

The identified Members States have different challenges and potential risks including spillover effects. Some Member States need to correct accumulated imbalances on both the internal and external side. They will have to reduce high levels of overall indebtedness and regain competitiveness so as to improve their growth prospects and export performance. In-depth analysis will help to assess the drivers of productivity, competitiveness and trade developments as well as the implications of the accumulated level of indebtedness and the degree of related imbalances in several Member States. Some countries are experiencing rapid adjustment partly due to catching-up effects and these developments may require a closer examination. Despite overall good macroeconomic performance some countries display developments in asset markets, including in particular housing, and a continuous build-up of indebtedness in the private sector, which also warrant further analysis.

Finally, the economic reading of the scoreboard indicators points to the need for further horizontal analysis on the drivers and policy implications of **large and sustained current account surpluses**, especially in some euro area Member States. In the next months, the Commission will undertake further assessment of the divergence in economic performance across Member States, including exploring trade and financial interlinkages between deficit and surplus countries and examine ways for further re-balancing at the level of the euro area and within the global context. It will also assess the role played by structural factors, including the functioning of services markets, through their impact on domestic consumption

[23] See also the Macro-economic Annex to the Annual Growth Survey: http://ec.europa.eu/commission_2010-2014/president/news/documents/pdf/annex_2_en.pdf

[24] This is also in line with the approach taken in the Commissions proposal .presented on the 23 November 2011 for a regulation on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area – COM(2011) 819final.

and investment, as a driver of sustained surpluses and thus pointing towards the necessary policy guidance. In this context the Commission will also study further the role played by catching-up effects.

In the context of multilateral surveillance and in line with Article 3.4 of the Regulation, the Commission invites the Council and the Euro Group to discuss this report. The Commission is also looking forward to feedback from the European Parliament and other stakeholders. Taking into account these discussions, the Commission will start to prepare in-depth reviews for the relevant Member States.