



**COUNCIL OF
THE EUROPEAN UNION**

**Brussels, 18 November 2013
(OR. en)**

15808/13

**UEM 376
ECOFIN 985
SOC 905**

COVER NOTE

From:	General Secretariat of the Council
To:	Coreper / Council
No. Cion doc.:	COM(2013) 790 final
Subject:	REPORT FROM THE COMMISSION Alert Mechanism Report 2014 (prepared in accordance with Articles 3 and 4 of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances)

Delegations will find attached document COM(2013) 790 final.

Encl.: COM(2013) 790 final



Brussels, 13.11.2013
COM(2013) 790 final

**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE
COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROPEAN
ECONOMIC AND SOCIAL COMMITTEE**

Alert Mechanism Report 2014

**(prepared in accordance with Articles 3 and 4 of Regulation (EU) No 1176/2011 on the
prevention and correction of macroeconomic imbalances)**

{SWD(2013) 790 final}

{SWD(2013) 791 final}

The Alert Mechanism Report (AMR) is the starting point of the yearly cycle of the Macroeconomic Imbalance Procedure (MIP), which aims at identifying and addressing imbalances that hinder the smooth functioning of the EU economies and may jeopardise the proper functioning of the Economic and Monetary Union. The AMR identifies the Member States for which further analysis (in the form of an in-depth review) is necessary in order to decide whether an imbalance in need of policy action exists. In this regard, the AMR is an initial screening device, based on a scoreboard of indicators with indicative thresholds, plus a set of auxiliary indicators. The AMR is not a mechanical exercise and it is not because a Member State reports an indicator beyond the indicative thresholds that an in-depth review is launched, as the Commission takes the complete economic picture into account.

It is only on the basis of the in-depth reviews that the Commission will conclude whether imbalances, and potentially excessive imbalances, exist and put forward the appropriate policy recommendations. The in-depth reviews will be published in spring 2014 and will feed into the analysis underpinning next year's country-specific recommendations under the 'European Semester' of economic policy coordination.

1. EXECUTIVE SUMMARY

The EU economies continue to progress in correcting their external and internal imbalances.

These imbalances, notably abundant credit, large and persistent current account deficits and surpluses, losses of competitiveness and accumulation of debt contributed to the crisis. Over the latest years, there has been progress in several areas. In particular, a reduction in government deficits and significant improvements in cost competitiveness, stimulated by structural reforms and market pressure, have been recorded in a number of Member States.

However, further progress is needed to address the imbalances. The imbalances, which aggravated the crisis, accumulated for a decade or so take time to overcome and the necessary policies should contribute to the structural change of the economies. There has been little progress so far in reducing excessive private debt, although credit flows have been very low or even negative in many countries; improvement in the net international investment position (NIIP) of the most indebted economies has been slow. Moreover, much less rebalancing has occurred in Member States with high surpluses, suggesting inefficient levels of saving and investment; as the Commission has recommended, a strengthening of the contribution to growth of their domestic demand would smooth the overall adjustment in the euro area. Several countries in which the imbalances require urgent adjustment have experienced a severe deterioration of their employment and social situation, with increases in unemployment and poverty leading to strong divergences across Member States.

This report initiates the third round of implementing the macroeconomic imbalance procedure (MIP)¹. The procedure aims at identifying and addressing imbalances that hinder the

¹ This Report is accompanied by two working documents: a first note elaborates on a number of technical changes in the indicators used in the scoreboard and auxiliary indicators. A second document contains a wealth of statistics on the basis of which this report has been prepared. Refer also to the *Eurostat News Release* 166/2013, and to the recent proposal for a Regulation on the provision of statistics for the macroeconomic imbalances procedure - COM(2013) 342, 7.6.2013. The latter aims to ensure the appropriate monitoring by Eurostat of the quality of data, as well as issues linked to compilation and transmission of data and metadata.

smooth functioning of the Member States' economies, of the euro area or of the EU as a whole. The implementation of the MIP is embedded in the 'European Semester,' with the aim of ensuring consistency with other economic surveillance tools. This way, appropriate recommendations have been given to Member States. The Annual Growth Survey (AGS)², which is adopted at the same time of this report, elaborates on the interlinkages between the correction of macroeconomic imbalances under the MIP, and the urgent challenges of ensuring sustainable fiscal policies, restoring lending, promoting growth and competitiveness, fighting unemployment and the social consequences of the crisis, and modernising public administration. In the coming days, the Commission is also adopting opinions on draft budgetary plans of the euro area Member States (except those that are subject to a macroeconomic adjustment programme), and on the euro area fiscal stance. It also transmits to the Council proposal for opinions on the economic partnership programmes of several Member States.

The Alert Mechanism Report (AMR) identifies the Member States which may be affected by imbalances, and for which further analysis should be undertaken before concluding on the existence or persistence of imbalances and their nature. In this regard, the AMR is an initial screening device, based on a scoreboard of indicators with indicative thresholds, plus a set of auxiliary indicators, at the beginning of the annual cycle of economic policy coordination. In line with the Communication 'Strengthening the Social Dimension of the Economic and Monetary Union'³, this report includes for the first time a set of social indicators which are useful for the interpretation of the scoreboard. The more detailed analysis will be performed in the subsequent in-depth reviews (IDRs). It will be on the basis of the IDRs that the Commission will conclude whether imbalances, and excessive imbalances, exist and put forward the appropriate policy recommendations.

This report shows that it is necessary to analyse in further detail the accumulation and unwinding of imbalances, and the related risks, in 16 Member States. For some countries the IDRs will elaborate on the findings of the previous MIP cycle⁴, while for others, it will be the first time the Commission will prepare an IDR. The several Member States for which the Commission intends to prepare an IDR have different challenges and potential risks including spillovers on their partners.

- For **Spain** and **Slovenia**, the IDRs will assess whether the *excessive imbalances* persist or unwind, and the contribution of the structural policies implemented by these Member States to overcome these imbalances;
- For **France**, **Italy** and **Hungary**, Member States with *imbalances* and for which the Commission indicated the necessity of adopting decisive policy actions, the respective IDR will assess the persistence of imbalances;

² COM(2013) 800, 13.11.2013. See also the Commission draft for the Joint Employment Report.

³ COM(2013) 690, 2.10.2013. The Communication also proposes a scoreboard of key indicators to be used in the draft Joint Employment Report to follow employment and social developments and identify problems in those areas at an early stage. The Council will assess in December whether to use it in the 2014 European Semester.

⁴ In April 2013, the Commission identified imbalances in Belgium, Bulgaria, Denmark, Spain, France, Italy, Hungary, Malta, the Netherlands, Slovenia, Finland, Sweden and the United Kingdom, among which Spain and Slovenia were experiencing excessive imbalances (*cf.* 'Results of the In-depth Reviews,' - COM(2013) 199, 10.4.2013, and 'Macroeconomic Imbalances,' *European Economy-Occasional Papers*, 132-144). For the full set of country-specific recommendations adopted by the Council, including those which are relevant to overcome imbalances, see OJ C 217, 30.7.2013, p. 1.

- For the other Member States previously identified as experiencing *imbalances* (**Belgium, Bulgaria, Denmark, Malta, Netherlands, Finland, Sweden** and the **United Kingdom**), the IDR will contribute to assess for which Member States imbalances persist or for which they have been overcome. The Commission takes the view that, since imbalances are identified after the detailed analyses in the previous IDRs, the conclusion that an imbalance has been overcome should also take place only after duly considering all relevant factors in another in-depth review, which could potentially lead to the closure of the MIP for some Member States;
- IDRs will also be prepared for **Germany** and **Luxembourg** in order to better scrutinise their external position and analyse internal developments, and assess whether any of these countries is experiencing imbalances;
- Finally, an IDR is also warranted for **Croatia**, a new Member of the EU, given the need to understand the nature and potential risks related to its external position, trade performance and competitiveness, as well as internal developments.

For the Member States that are subject to macroeconomic adjustment programmes and benefiting from financial assistance, the surveillance of their imbalances and monitoring of corrective measures will take place in the context of their programmes. This concerns Ireland, Greece, Cyprus, Portugal and Romania; and the situation of Ireland in the context of the MIP will be assessed after the conclusion of the programme.

In the context of multilateral surveillance and in line with Article 3(5) of Regulation No 1176/2011⁵, 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 appropriately liaising with relevant stakeholders. Taking into account the discussions within the Council and the Euro Group, the Commission will prepare in-depth reviews for the relevant Member States. These are expected to be published in spring 2014, ahead of the preparation of the National Reform Programmes and the 'European Semester' package of country-specific recommendations.

⁵ OJ L 306, 23.11.2011, p. 25.

2. PROGRESS IN THE CORRECTION OF IMBALANCES

Over the last year, most EU Member States advanced in correcting their imbalances. This concerns not only the current account deficits and the main competitiveness indicators, but also the fiscal accounts, the private balance sheets and the financial sectors. However, the deleveraging pressures faced by the private and government sectors of many Member States keep weighing on economic activity; domestic demand in several economies is dampened by the need to increase the households' savings and in some cases by wage developments, and for companies to reduce debt. Moreover, the low level of economic activity as a consequence of the crisis has increased the unemployment rates, and deteriorated a number of other social indicators.

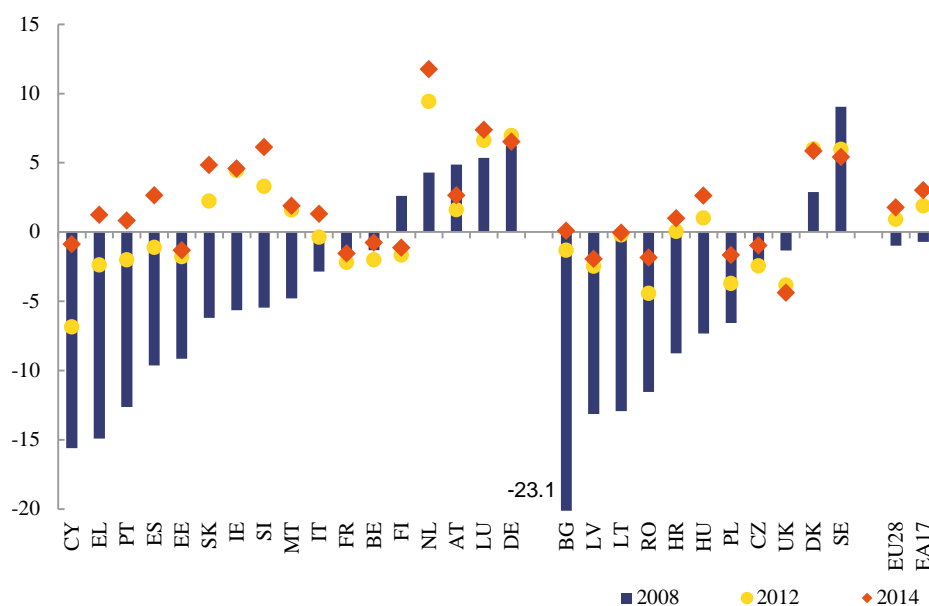
The correction of imbalances contributes to improve the fundamentals and to a gradual recovery. At the same time, the progressive normalisation in economic conditions helps in reducing the imbalance-related macroeconomic risks. The growth outlook⁶ is now better than a year ago, and progress in the correction of external and internal macroeconomic imbalances will open up the way for growth and convergence. Over the past few months, economic news has been encouraging. After several quarters of contraction, GDP in the second quarter grew by 0.3 per cent in both the euro area, and in the EU. For the second half of the year, key indicators are signalling a continuation along this path albeit at a moderate pace. The gradual rebound of domestic demand and, supported by gains in competitiveness, the expansion of exports also confirm the outlook for a recovery gaining traction next year. As regards the different areas under the scope of the MIP the following cross-country observations can be made:

- **There has been a remarkable improvement in the current accounts of the Member States which used to have large deficits** (Graph 1). This has been in particular the case in Member States implementing a macroeconomic adjustment programme supported by financial assistance (EL, IE, CY, PT and RO), as well as in BG, EE, ES, LT, LV, SI and SK, *i.e.* Member States that, until a few years ago registered the largest current account deficits and were experiencing unsustainable developments. Although a considerable improvement in their external accounts resulted from contractions in imports, which stemmed from a reduction in domestic demand and expenditure switching, there have also been favourable results in terms of exports. The improvement in the external position of the Member States that used to register large deficits includes cyclical and non-cyclical components. There is evidence that the improvements in the current account contain a large non-cyclical component, due to both expansion in exports and losses in income and thus falling imports, which are not expected to disappear with the firming up of the recovery⁷. The latest update of the scoreboard still shows an indicator for the current account deficit (a 3-year average for 2010-2) above the threshold of 4 per cent of GDP for PL, as well as for EL, CY, PT and RO. However, in 2013, ES, PT, SK and SI are actually expected to be in surplus, and only CY and RO had in 2012 a deficit of, or above, 4 per cent of GDP. Among the countries that have registered a deterioration in their external position in recent years, a specific attention should be given to FR and UK, which now post amongst the largest deficits in the EU, although their deficits are below the threshold.

⁶ Cf. 'European Economic Forecast-Autumn 2013,' *European Economy*, 2013 (7).

⁷ In other words, this means that the reduction in current account deficits has generally been more than one could expect given the estimated output gaps in the Member States concerned and their trading partners. For one method of estimating the cyclical component of current account balances, see Salto, M. and A. Turrini (2010), 'Comparing Alternative Methodologies for Real Exchange Rate Assessment,' *European Economy-Economic Papers*, 427.

Graph 1: Current Accounts Deficits (-) and Surpluses (+)
2008, 2012 and 2014 (forecast)
(% of GDP)



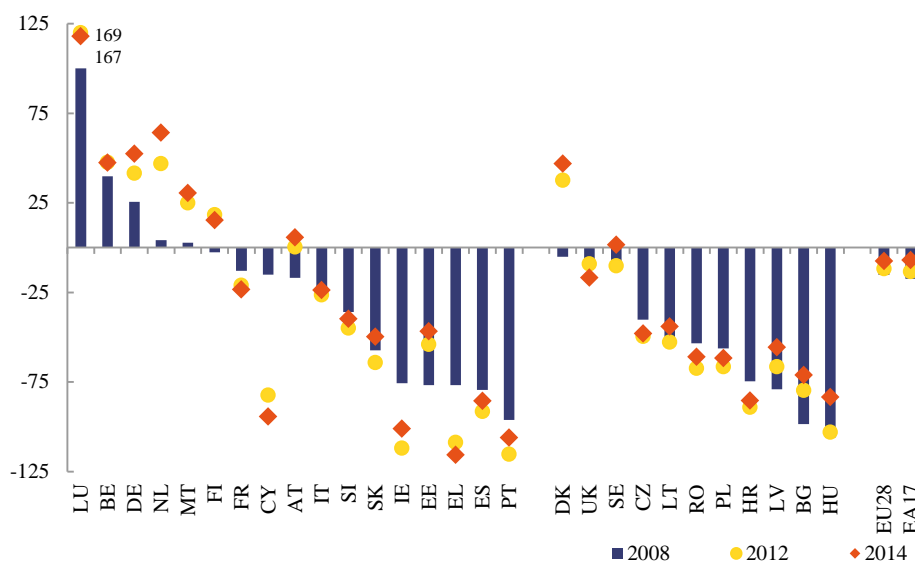
Source: Eurostat, Commission services.

- **However, the external sustainability of the most vulnerable economies has not yet been firmly re-established** (Graph 2). Most Member States register large negative NIIP. Inside the euro area, this is particularly the case of ES and EE, as well as the four programme countries PT, EL, IE and CY, and for BG, HR, HU, LV outside the euro area: each of them has a negative NIIP beyond 50 per cent of GDP, and in some cases (IE, EL, PT and HU) in excess of annual GDP. In particular the NIIP of CY has deteriorated at a very fast pace in recent years. The NIIP of CZ, LT, PL, SK and SI, and also RO are also more negative than the indicative threshold, but stable. All these Member States (with the exception of EL and CY) register in 2013 current account balances above those that stabilise their external liabilities in the medium term. Nevertheless, smaller deficits or even surpluses for a protracted period and more dynamic economic activity are necessary to reduce the NIIP to safer levels⁸. Moreover, the improvement in the NIIP ratios has not yet materialised in actual data in some countries given very low nominal growth. Large negative NIIP make these countries' financing conditions sensitive to changes in economic prospects and market jitters. The risks related to negative NIIP, including the impact on the economic activity and financial stability, depend a lot on the composition of liabilities; in that respect, countries with large stocks of inward foreign direct investment (notably BG, CZ, EE, SK, LT, LV and IE) are in better condition than those whose negative NIIP mainly reflect external debt⁹.

⁸ Cf. 'The Dynamics of International Investment Positions,' *Quarterly Report on the Euro Area*, 2012(3):7-20.

⁹ Cf. 'The Role of FDI in Preventing Imbalances in the Euro Area,' *Quarterly Report on the Euro Area*, 2013 (2): 17-25.

Graph 2: Net International Investment Positions
2008, 2012 and 2014 (projection)
(% of GDP)



Note: 2014 projections assume no valuation gains/losses.
Source: Eurostat, Commission services.

- For some Member States, the current account surpluses remain very high**, and well above the indicative threshold of 6 per cent of GDP (Graph 1 and Box 1). This is the case of DE, LU and NL and, to a lesser extent, also SE. The available forecasts suggest that these surpluses will not fall substantially any time soon. Although structural characteristics justify persistent moderate surpluses in each of these countries, the levels registered in the latest years and forecast through 2014 are well above historical levels and above most estimates of what their fundamentals would justify¹⁰. Since economic activity in DE has suffered less than in most partners, one may suspect that its cyclically-adjusted surplus is above the actual figures, but this does not appear to be the case for NL. The surpluses are the result of strong competitiveness and specialisation in the sectors for which the world demand is stronger – which are welcome developments –, but also mirror subdued domestic demand, itself reflecting structural impediments to domestically generated growth¹¹. An increase in investment and reduction in their overall savings would be welfare-improving for these countries, contribute to the sustainability of growth, without impairing their competitiveness, all the more as surplus countries tend to have lower than EU average investment-to-GDP ratios. At the same time, the large surpluses may also reflect inefficiencies in financial intermediation. The combination of these large surpluses and the above-described reduction in deficits mean that the euro area, which used to have a balanced external position has shifted to a surplus above 2 per cent of GDP¹². This might put pressure on the euro to appreciate vis-à-vis other international currencies and require even stronger efforts of the vulnerable countries to deleverage and to recover competitiveness through cost adjustment.

¹⁰ See e.g. IMF (2013), 'Multilateral Policy Issues Report - 2013 Pilot External Sector Report,' (June), and 'Germany-Staff Report for the 2013 Article IV Consultation,' (August).

¹¹ These issues were already addressed in previous years' recommendations (CSRs) to these Member States.

¹² Cf. 'Current Account Surpluses in the EU,' *European Economy*, 2012 (9).

- **There have been gains in price and non-price competitiveness in several countries, in particular the most vulnerable.** In the latest update of the MIP scoreboard, in clear contrast with the situation of just a few years ago, no Member State (except LU) registers an increase in nominal unit labour costs (ULC) beyond the indicative threshold¹³. In the countries with the most dynamic increases in the past, there have been tangible reductions in ES, LV and LT, as well as in IE and EL¹⁴. The recovery in competitiveness is key to the adjustment process of the economies with largest challenges in external sustainability. Without those gains, the reduction in their deficits would take place mainly through contraction in imports and reduction in standards of living. Moreover, no country registers an *appreciation* in the real effective exchange rate (REER) above the indicative threshold. Actually, for several Member States, the REER *depreciation* rate has been beyond the threshold, given developments in the nominal exchange rate of the euro (and, for outside the euro area, of other national currencies). The non-price competitiveness is more complex to assess; however, there is also evidence of gains in several countries, with expansion of their exports to new markets and new sectors.
- **Export performance has improved for several countries, but most Member States keep losing market shares globally.** Over the last five years, only BG, EE, LV, LT, MT, PL and also RO, which together do not account for more than 5½ per cent of the EU exports, have increased their market shares, and only LV and LT gained shares in 2012. Market share losses have been particularly severe in HR, CY, IT, FI as well as EL. However, over the latest years, the export performance has become less heterogeneous among the EU countries, and there have been an improvement in the export performance of countries like ES and PT. The assessment of developments in export market share should take into account that the relative losses are related to the expansion of big emerging economies, like China, Brazil, Russia, India, among other. However, even when the performance is compared with other advanced economies, like the OECD countries, the export performance of most Member States over the last five years has not been favourable.
- **Balance sheet adjustments continue in many Member States but the private debt stocks remain high** (Graph 3). Despite on-going deleveraging efforts, the private sector debt still exceeds the indicative threshold in most Member States¹⁵. The pace and extent of the on-going adjustment varies, however, across countries. Indeed, sharp adjustments in ES, HU, LT and SI concurred with significant increases in the consolidated private debt-to-GDP ratios in BE, FR, and FI as well as CY and IE. The lion's share of the private sector adjustment in 2012 can be attributed to the households' deleveraging (particularly in DK, EE and UK, as well as PT)¹⁶.

¹³ On the link between ULC, export prices and rebalancing, cf. 'Labour Costs Pass-Through, Profits and Rebalancing in Vulnerable Member States,' *Quarterly Report on the Euro Area*, 2013 (3): 19-25.

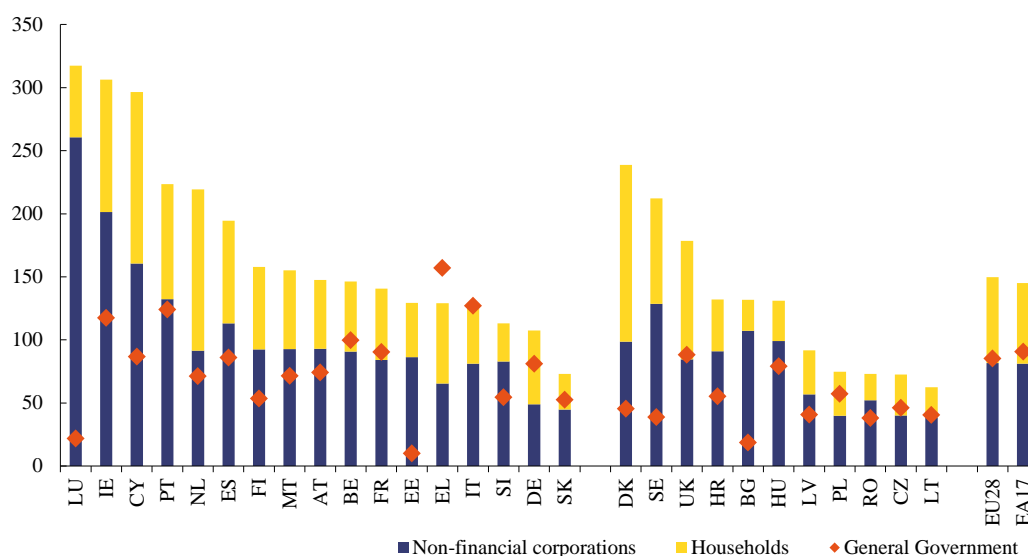
¹⁴ Cf. 'Labour Market Developments in Europe-2013,' *European Economy*, 2013 (6) and 'Benchmarks for the Assessment of Wage Developments,' *European Economy-Occasional Papers*, 146.

¹⁵ Cf. 'Refining the MIP Scoreboard - Technical Changes to the Scoreboard and Auxiliary Indicators,' *op. cit.*, on changes in the definition of private sector debt in the scoreboard.

¹⁶ Cf. 'Assessing the Private Sector Deleveraging Dynamics,' *Quarterly Report on the Euro Area*, 2013 (1): 26-32, and Cuerpo, C. *et al.* (2013), 'Indebtedness, Deleveraging Dynamics and Macroeconomic Adjustment,' *European Economy-Economic Papers*, 477.

- **The deleveraging dynamics is influenced by the underlying credit market conditions** and access to finance. In 2012, credit growth was generally below the threshold. This is related to both supply and demand factors, which are not easily distinguishable. Banks have downsized their balance sheets in several countries, as reflected in the indicator on financial sector liabilities. Falling net credit in 2012 in the programme countries EL, IE and PT presented an additional break on economic activity, thereby temporarily increasing their debt ratio via a denominator effect; negative feedback loops between necessary deleveraging pressures and economic activity continue to constitute a source of concern for some countries. On the contrary, adjustment in BG, DE, AT, PL and UK was done on the back of reduced credit market pressures and stronger nominal GDP growth. The sectorial breakdown reveals that among the countries experiencing deleveraging in the corporate sector, negative net credit flows appear as a significant contributor in ES, HU and SI, as well as in EL. Financing difficulties might ultimately lead to underinvestment in vulnerable Member States, delaying the recovery and the effective rebalancing of the economy towards more productive, export-oriented industries¹⁷.

Graph 3: Non-Financial Corporate, Household and General Government Debt
2012
(% of GDP)



Note: EU28 and EA17 aggregates for private debt constructed as the weighted average of consolidated country-level data.
Source: Eurostat.

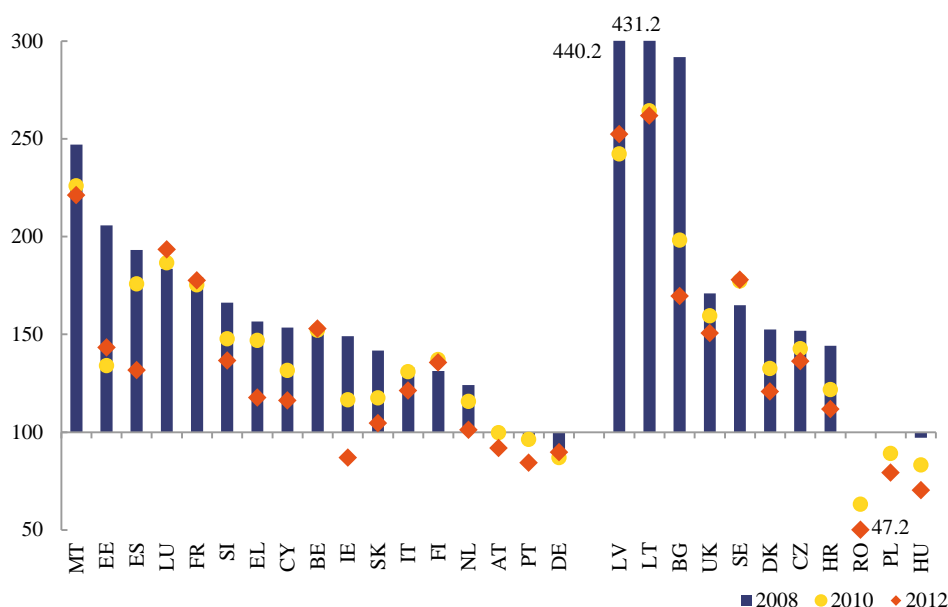
- **Reduction in house prices became widespread and gained pace** (Graph 4). Real house prices¹⁸ further adjusted in 2012, leaving BG, DK, ES, HU, IT, NL, SI and SK as well as in IE, PT and RO with substantial negative growth rates, in line with tightened credit conditions and household deleveraging efforts. Only in DE, EE, LU, MT and AT did deflated house prices grow. Moreover, the correction accelerated in 2012 in countries already facing a large cumulated fall since their peak, such as BG, ES, NL, SI and also CY. The downsizing of the property market comes along with policies towards rebalancing incentives away from home ownership and its debt financing. Important reforms aimed at fostering rental markets, lowering fiscal incentives for mortgage-related instruments or reducing household balance sheet

¹⁷ Cf. 'Product Market Review-2013,' *European Economy*, 2013 (forthcoming), and 'Drivers of Diverging Financing Conditions across Member States,' *Quarterly Report on the Euro Area*, 2013 (1): 19-25.

¹⁸ Relative (or real) house prices, i.e. prices deflated by the consumption deflator.

vulnerability to income and interest rate shocks may contribute to reduce the volatility in housing markets and mitigate the economic impact of their ups and downs¹⁹.

Graph 4: House prices (deflated)
2008, 2010 and 2012
(index 2000=100, u.o.i.)



Note: Due to missing data, the base years are 2004 for CZ, 2003 for EE and SI, 2002 for CY, 2006 for SK, 2007 for HU and 2008 for PL, AT and RO. Moreover, because of incomplete data, for AT, the red diamond refers to 2011; available information indicates strong growth for 2012.

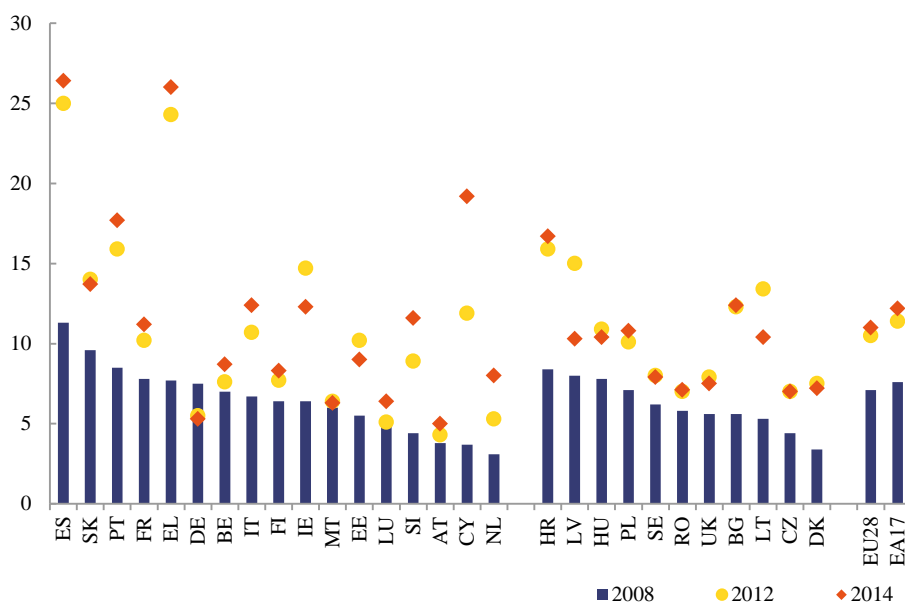
Source: Eurostat, ECB, OECD, BIS.

- **The employment and social situation deteriorated in a number of countries during the rebalancing process.** In particular, unemployment has grown very substantially in several Member States. ES, HR, LV, LT and SK, and also EL, IE, CY and PT register high or very high unemployment rates (Graph 5). Only in DE was the unemployment rate lower in 2012 than in 2008, and only a few Member States have recorded contained increases in joblessness in the latest number of years. Other measures of unemployment, like the youth and long-term unemployment also increased substantially, in particular in EL, and ES, leading to strong divergences within the EU. Weak economic activity and, in some cases, the downsizing of important labour-intensive sectors such as construction (e.g. in ES and SI, and IE) are part of the adjustment process inducing a shift of resources from non-tradables to the tradable sector and the switching of expenditure to domestically-produced goods. Still, whereas the reallocation of resources is unavoidable and desirable, that process is not costless. In addition, high unemployment points to underperformance of the overall economy, the depreciation of human capital and lower potential growth prospects. Several reform streams, both on labour and product markets help in smoothing the process, but the increases in unemployment have been

¹⁹ Cf. 'Assessing the dynamics of house prices in the euro area,' *Quarterly Report on the Euro Area*, 2012 (4): 7-18, 'Taxation of Housing,' *Quarterly Report on the Euro Area*, 2012 (4): 25-30 and 'Tax Reforms in EU Member States 2013,' *European Economy*, 2013(5), in particular Section 2.6. On housing-related risks, see Pataracchia, B., R. Raciborski, M. Ratto and W. Röger (2013), 'Endogenous Housing Risk in an Estimated DSGE Model of the Euro Area,' *European Economy-Economic Papers*, 505.

very substantial, exceeding previous peaks in many Member States. To better consider the social impact of the imbalances and of the adjustment, a number of social indicators have been added to the auxiliary indicators for the economic reading of the scoreboard. The unemployment rate shows deterioration in labour market matching; increase rates of long-term and youth unemployment, inactivity, poverty and social exclusion denote an underutilisation of resources and deterioration in social cohesion.

Graph 5: Unemployment rate
2008, 2012 and 2014 (forecast)



Source: Commission services.

- Intra EU-labour mobility is increasing.** In 2012, intra-EU migration amounted to 6½ million, an increase of 200 thousand in relation with 2011, increasingly reflecting the labour market situation. In LV and LT, reflecting some improvement in the labour market, the negative net migration was more moderate than in previous years. By contrast, in PT and ES, increases in the unemployment rates have led to an acceleration of net migration outflows in both countries, though comprising to a considerable extent returning non-EU migrants. Simultaneously, countries with relatively low unemployment rates, such as DE, AT and SE continued to register increases in net immigration. Migration can play a role in the adjustment by facilitating the reallocation of labour from areas affected by unemployment to areas where labour demand is robust. However, countries experiencing negative net migration outflows need to continue to implement policies to improve their potential growth so that, in the medium term, they gain the capacity to attract skilled labour which they may be losing during this adjustment phase.

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

The commentaries below do not cover Member States which are subject to surveillance under macroeconomic adjustment programmes supported by financial assistance²⁰. This concerns Greece, Cyprus, Portugal and Romania; the case of Ireland is discussed in this report but its situation in the context of the MIP will be assessed at the end of the on-going financial assistance, which is expected for February 2014.

Belgium: In April 2013, the Commission concluded that Belgium was experiencing macroeconomic imbalances in particular involving competitiveness and indebtedness, especially concerning the implications for the real economy of the high government debt. In the updated scoreboard, some indicators, the same as last year, exceed their indicative thresholds, namely the losses in export market shares, as well as private and government sector debts. The long-term trend in losses in export market shares accelerated in 2012 with implications on the continued negative development of the goods balance. The current account position has further deteriorated, and now posts a small deficit. However the NIIP remains stable and positive. Regarding cost competitiveness, the available indicators point to some stabilisation. Nevertheless, ULC, while below the indicative threshold, accelerated again in 2012, though is expected to moderate in 2013. The REER depreciated somewhat in 2012 in line with the euro exchange rate. In 2012, private debt increased and remains well above the threshold, even when consolidating for domestic intercompany loans. The government debt has continued to increase and is expected to surpass 100 per cent of GDP in 2013, although it is forecast to broadly stabilize in the coming years. Moreover, contingent liabilities also have to be monitored as they might impact the position of public finances, as well as the real economy. Financial sector liabilities decreased in 2012 while the sector leverage fell to the lowest level in five years. House prices decreased slightly in 2012, after being stable since 2008, indicating that the adjustment is gradually taking place. *Overall, the Commission finds it useful, also taking into account the identification of imbalances in April, to examine further the persistence of imbalances or their unwinding.*

Bulgaria: In April 2013, the Commission concluded that Bulgaria was experiencing macroeconomic imbalances, in particular involving the impact of deleveraging in the corporate sector as well as the continuous adjustment of external positions, competitiveness and labour markets. In the updated scoreboard, a few indicators are above the indicative threshold, namely the NIIP and unemployment. The risks from the external position appear to have been reduced compared to a few years ago. The negative NIIP remains high, while net external debt is substantially lower, given the stock of foreign direct investment (FDI). Moreover, both the negative NIIP and net external debt are on a similar downward trend, driven by the adjustment of the current account towards balance and a continued positive contribution of capital transfers. The current account correction appears to be mainly non-cyclical and had a relatively small impact on economic activity. Price and cost competitiveness indicators have continued to improve and appear supportive for future exports growth. The nominal ULC indicator has aligned with the scoreboard thresholds as

²⁰ This approach which avoids duplication of procedures and reporting obligations has been established in Regulation (EU) No 472/2013 (OJ L 140, 27.5.2013, p. 1), which is part of the so-called 'two-pack.' It is also in line with the Commission proposal on a facility for providing financial assistance for Member States outside the euro area - COM(2012) 336, 22.6.2012. For detailed discussions of the economic situation and progress in the unwinding of imbalances in those Member States, see the latest compliance reports: in *European Economy-Occasional Papers*, 162 (Ireland), 159 (Greece), 161 (Cyprus), 156 (Romania) and 153 (Portugal). Spain is discussed in this report though it benefits from official financing for the recapitalisation of banks; cf. *European Economy-Occasional Papers*, 155. On the 'two-pack,' see 'The Two-Pack on Economic Governance,' *European Economy-Occasional Papers*, 147.

of 2012, based on lower wage growth and sustained productivity increases, reflecting also labour shedding. Private sector deleveraging is on-going. Non-financial corporates' debt is relatively high in Bulgaria compared to peer countries although a large part of it results from cross border intra-company loans. Credit remains subdued reflecting the sluggish economic recovery. The labour market remains weak and unemployment, including youth and long-term unemployment, has continued to increase, although it appears to be levelling-off in the course of 2013. Poverty and social exclusion have also increased in the latest years, and NEET rate²¹ is the highest in the EU. *Overall, the Commission finds it useful, also taking into account the identification of imbalances in April, to examine further the persistence of imbalances or their unwinding.*

Czech Republic: In the previous rounds of the MIP, the Czech Republic was not identified as experiencing imbalances. In the updated scoreboard, the NIIP is negative and continues to be beyond the indicative threshold. This indicator has further deteriorated because of deficits in the current account, which have been between 2½-3 per cent of GDP, but are expected to decline over the coming years. The risks related to the external position remain limited as much of the foreign liabilities are accounted for by FDI and, consequently, net external debt is very low. While FDI helped improve the export performance at the beginning of the century, gains in export market shares have substantially eased and even turned to moderate losses in 2010-2. Economy-wide competitiveness indicators, such as the REER and ULC, have so far not improved strongly enough to make for improved prospects of export performance over the coming years. On the internal side, the inflow of foreign capital contributed to rapid growth in real house prices before the crisis. While the ongoing correction in prices has not substantially impinged on the soundness of the financial sector, credit growth has been subdued for a number of years. The private sector debt ratio is still well below the indicative threshold. Overall, the labour market has weathered the recent weakness in the economic activity relatively well, with the unemployment rate rising to 7 per cent in 2012. However, youth unemployment (19½ per cent in 2012), though below the EU average, has more than doubled since 2008 and is not likely to improve before economic activity gathers pace again. *Overall, the Commission will at this stage not carry out further in-depth analysis in the context of the MIP.*

Denmark: In April 2013, the Commission concluded that Denmark was experiencing macroeconomic imbalances involving the high level of household debt and the continuing adjustment in the housing market. In the updated scoreboard, the same indicators as last year are above their indicative thresholds, namely the private sector debt and losses in export market shares. The latter are linked to the deterioration of competitiveness over the last decade. However, the current moderation in wage growth and in nominal ULC as well as the depreciation in the REER are expected to support the already on-going recovery of competitiveness. The current account has been in positive territory for more than two decades and the surplus is currently close to the upper threshold of the scoreboard, while the NIIP has continued to strengthen. The increase in house prices in the years before 2008 pushed household debt to very high levels. The private sector debt is, thus, well above the threshold but has been on a decreasing path since 2009. Moreover, the concentration of debt in high-income households reduces the risks related to interest rate shocks. The housing market is still sluggish, though prices have picked-up somewhat over the last year. *Overall, the Commission finds it useful also taking into account the identification of imbalances in April, to examine further the persistence of imbalances or their unwinding.*

Germany: In the previous rounds of the MIP, Germany was not identified as experiencing imbalances. In the updated scoreboard a number of indicators exceed the respective indicative

²¹ Young people not in employment, education or training.

thresholds, namely the current account surplus, the depreciation in the REER, the losses in export market shares and the government sector debt. On the external side, the indicator relating to the current account balance is well above the indicative threshold and the German current account surplus accounts for most of the euro area surplus, given the size of the German economy. Following statistical revisions, the indicator has exceeded the threshold each year since 2007. Latest quarterly data and the Commission autumn forecast indicate a surplus in 2013 at the same level as in 2012: 7 per cent of GDP. Looking ahead, according to the latest Commission services' forecasts, the surplus is expected to remain above the indicative threshold over the forecast horizon, thus suggesting that it is not a short-lived cyclical phenomenon. The large surpluses are reflected in a strongly positive and increasing NIIP and positive income balances. They may put pressure on the euro to appreciate vis-à-vis other currencies. In case such pressures materialise, this would make it more difficult for the peripheral countries to recover competitiveness through internal depreciation. The large surplus reflects higher savings than investment in the German economy. The household saving rate is among the highest in the euro area. Despite the second-lowest share of private sector (firms and households) debt in GDP in the euro area and favourable interest rate conditions, private sector deleveraging has continued, albeit at a reduced pace, thus failing to support a more buoyant private demand. Private credit flows have remained moderate while gross fixed capital formation declined last year. Previous recommendations focused on the need to strengthen domestic sources of potential growth against the background of unfavourable demographic prospects. The dynamics of Germany's external position warrant further investigation with a view to better understanding *i.a.* the role of certain domestic features, including financial flows, for the sectorial savings-investment balances and current account developments. The HICP-based REER depreciated in 2010-12 mostly vis-à-vis non-euro area partners, reflecting the nominal depreciation of the euro, but less so vis-à-vis the euro peers. This has contributed to the German firms' competitiveness vis-à-vis their non-euro competitors. ULC continue to increase above the euro area average, on the back of a robust labour market, with increasing wages, and relatively low productivity growth. The associated appreciation of the corresponding REER is, however, small compared to the gains recorded in the pre-crisis decade. General government sector debt is above the indicative threshold but projected to decline from 2013. House prices have increased moderately, with stronger hikes in some urban areas. *Overall, the Commission finds it useful to conduct an in-depth analysis with a view to assessing whether imbalances exist.*

Estonia: In the previous rounds of the MIP, Estonia was not identified as experiencing imbalances. In the updated scoreboard, a few indicators are still above the indicative thresholds, namely the negative NIIP and unemployment. While the negative NIIP remains significantly beyond the threshold (-54 per cent of GDP in 2012), it is improving, despite a small current account deficit. The latter is in turn explained by a shrinking trade surplus --owed to some losses in export shares, which partly reflects rising nominal ULC -- and to a recovering domestic demand. However, since half of the external liabilities consist of FDI, risks remain limited. In terms of external debt, Estonia has turned into a net creditor. In parallel, while the unemployment indicator exceeds the scoreboard threshold, it is rapidly decreasing, to 9¼ per cent by end-2013. Nevertheless, long-term unemployment remains relatively high as well as other indicators related to poverty, social exclusion, severe material deprivation and low work intensity. The country's private sector indebtedness has continued to contract, down to a level of 129 per cent of GDP in 2012, supported by robust nominal GDP growth. However, private sector deleveraging has almost come to a halt; the still relatively high private debt stock will likely limit credit growth in the future and constitute a drag on output growth in the medium term. *Overall, the Commission will at this stage not carry out further in-depth analysis in the context of MIP.*

Ireland: Since December 2010 Ireland has been implementing an macroeconomic adjustment programme with financial assistance; the surveillance of imbalances and the monitoring of

corrective measures have taken place under that context and not the MIP. Under the programme, Ireland has made considerable strides towards correcting its excessive imbalances. In the updated scoreboard, several indicators are beyond the threshold, namely the negative NIIP, the depreciation in the REER, losses in export market shares, private and government sector debt and unemployment. As regards external imbalances, the current account has been in surplus since 2010, but this has yet to translate into an improving NIIP, largely as a result of valuation effects, which are, however, themselves a sign of confidence in the economy. Also the external liabilities-related risks need to be put in the perspective of large inward FDI stocks. Falling ULC and a depreciation of the REER have corrected the excesses of the boom years and translated into competitiveness gains. As a consequence, the loss in market shares slowed in 2012, with the remaining erosion taking place against the background of a significant shift in the composition of merchandise exports, the effects of key exported drugs coming off patent and a shift towards services exports. As regards internal imbalances, house prices, which fell for five years and are currently undervalued according to several metrics, have stabilised or started to rise modestly. Although the private sector debt remains above the threshold, deleveraging has progressed well despite strong headwinds from falls in disposable income. In parallel, banks have been required to step up their efforts to reduce their non-performing loans portfolio, particularly through completing sustainable solutions for mortgages in arrears. The underlying health of the banks' balance sheet is also being assessed through a comprehensive assessment under the programme. Strict adherence to the fiscal targets agreed under the programme means that general government sector debt as a percentage of GDP is projected to peak in 2013 and to decline thereafter. Although the unemployment rate remains above the threshold, it has been on a declining trend since mid-2012, falling to 13¼ per cent in September 2013 from the peak of 15 per cent in early 2012. Nevertheless, long-term and youth unemployment remain particularly critical issues, and poverty and social exclusion increased markedly during the latest years. *The on-going financial assistance and adjustment programme contributed to reduce macroeconomic imbalances and manage the related risks. The situation of Ireland in the context of the MIP will be assessed after the conclusion of the programme.*

Spain: In April 2013, the Commission concluded that Spain was experiencing excessive macroeconomic imbalances, in particular as very high domestic and external debt levels continued posing risks for growth and financial stability²². Moreover, despite the on-going rebalancing in the economy, the magnitude of the necessary adjustment and additional vulnerabilities related to soaring unemployment and growing general government sector debt represented a substantial challenge going ahead, requiring continued policy action. In the updated scoreboard, several indicators are above the indicative threshold, namely the negative NIIP; the depreciation in the REER; losses in export market shares; private and general government sector debts and unemployment. The significant adjustment in the current account, driven by robust export growth and declining imports, has brought the scoreboard indicator below the threshold. In 2013, the current account is turning in surplus, which is expected to increase in next years. However, the negative NIIP has not yet stabilised; a deterioration in 2012 was driven mainly by valuation effects, which can be seen as a sign of confidence in the economy. The recovery in competitiveness accelerated in 2012 as wage moderation added to the on-going strong productivity advances (though largely driven by labour shedding) in reducing ULC. The cumulative improvement in the REER has surpassed the indicative threshold and is offsetting the appreciation registered in

²² However, the corrective arm of MIP was not triggered given the ambition of the national reform programme (NRP) and stability programme (SP) of Spain. The Commission is closely monitoring the implementation of the policy reforms and compliance with the MIP-relevant recommendations adopted by the Council in July. This monitoring shows that there has been a visible stepping up of the pace of reforms over the last months. Despite some delays, the reforms have been progressing largely in line with the commitments in the NRP and SP and the MIP-relevant recommendations adopted by the Council in July.

previous periods. Losses in export market shares have continued. The relative deterioration is, however, more moderate when considered against other advanced countries. The government debt is rapidly increasing on account of public deficits, bank recapitalisation and settlement of arrears to suppliers. Private sector deleveraging has continued, primarily via negative credit flows; the deleveraging of households has been somewhat slower than for corporates reflecting the longer maturities of predominantly mortgage-related debt and less recourse to insolvency procedures. The adjustment process in the housing market has accelerated, due to a large overhang of unsold properties and weak fundamentals. The social costs of the crisis are increasingly discernible. High shares of long-term and youth unemployment, and an increasing number of households with very low work intensity, combined with falling household incomes, are taking their toll, leading to an increase in poverty and social exclusion. *Overall, the Commission finds it useful, also taking into account the identification of excessive imbalances in April, to examine further the persistence of macroeconomic risks and to monitor progress in the unwinding of imbalances.*

France: In April 2013, the Commission concluded that France was experiencing macroeconomic imbalances and indicated the necessity of adopting decisive policy actions. The imbalances concerned in particular the deterioration in the current account and in competitiveness and high general government sector debt. In the updated scoreboard, a number of indicators are above their indicative thresholds, namely, as last year, losses in export market shares, private debt and general government sector debt indicator and now also the depreciation in the REER indicator. The reading of the scoreboard still points to issues on both the external and internal sides. France continues to lose market shares, although slightly less than the EU (or the euro area) as a whole. These losses are reflected in a deterioration in the current account balance and in the negative NIIP, although these remain well below their indicative thresholds. This evolution has taken place in spite of depreciating REER and relatively contained ULC, further putting the emphasis on non-price competitiveness. Indeed, previous analyses have pointed to the negative impact that the poor profitability of French companies has on their investment potential as well as their innovation capacity to the detriment of their competitiveness. The low profitability of firms also weighs on their deleveraging capacity and therefore contributes to the increase in private indebtedness. At the same time, household debt remains relatively low although their creditworthiness was dented by the decrease in households' disposable income in a context of rising unemployment. The increase in the level of private debt is worrying in a context of still increasing general government sector indebtedness, which is now beyond 90 per cent of GDP. *Overall, the Commission finds it useful, also taking into account the identification of imbalances in April, to examine further the risks involved in the persistence of imbalances.*

Croatia joined the EU on 1 July 2013. In the MIP scoreboard, a number of indicators are above the indicative thresholds, namely the NIIP, losses in export market shares and the unemployment rate. The negative NIIP of close to 90 per cent of GDP at the end of 2012 is mainly the result of the accumulation of current account deficits before the global crisis. Since the onset of the global crisis, the current account has gradually adjusted to an almost balanced position in 2012, largely reflecting depressed domestic demand, while export performance has been weak. Growing ULC, coupled with unfavourable product specialisation and geographical orientation of exports, have led to a substantial decline in export market shares. Large capital inflows in the pre-crisis period resulted in the accumulation of private sector debt, although recently the private debt ratio has been levelling off, and declined to slightly below the indicative threshold at end-2012. The share of non-performing loans has increased significantly since 2008, mainly in the corporate sector and also partly due to higher debt service for households exposed to Swiss Franc-denominated loans. Deleveraging pressures weigh on the prospects for an economic recovery. At the same time, due to the contracting economy and the absence of any substantial fiscal adjustment, general government sector debt has increased rapidly. Furthermore, the debt overhang of state-owned enterprises implies

contingent liabilities for the government. The regulatory burden and insufficient competition in many sectors of the economy remain serious impediments to growth and job creation. The prolonged recession, coupled with rigidities in the labour market and bottlenecks in social security has led to a fall in employment, mostly in the private sector, while the unemployment rate has increased substantially to almost 16 per cent in 2012. A youth unemployment ratio above 40 per cent is a particular problem. The high share of long-term unemployed suggests problems of a structural nature. The share of people at risk of poverty is on an upward trend and among the highest in the EU. *Overall, the Commission finds it useful to conduct an in-depth analysis with a view to assessing whether imbalances exist.*

Italy: In April 2013, the Commission concluded that Italy was experiencing macroeconomic imbalances and indicated the necessity of adopting decisive policy actions. The imbalances concerned in particular its export performance and underlying loss of competitiveness, as well as high general government sector indebtedness. In the updated scoreboard, a number of indicators are above the indicative threshold: the loss in export market shares, the depreciation in REER, and general government sector debt. The loss in market share remains significantly above the indicative threshold, and export performance compares unfavourably to that of other advanced economies. Exports towards non-euro area trade partners have been supported by a significant fall in the REER up to mid-2012, mainly driven by a nominal depreciation of the euro. Meanwhile, a dismal productivity performance continues to sustain nominal ULC which in 2012 rose more than for most trade partners. Falling domestic demand, and the strong contraction of investment in particular, has been the main driver of the improvement in the current account balance, which is forecast to turn into surplus in 2013. On the internal side, the high level of general government sector debt remains a significant vulnerability for the country, in particular given the weak growth outlook. In 2012, the government sector debt as a share of GDP rose to 127 per cent, due to contracting economic activity and increasing interest expenditure, while the primary surplus (at 2½ per cent of GDP) mitigated the increase. Achieving and maintaining an elevated primary surplus remains critical to put the debt ratio on a steadily declining path. Private-sector indebtedness remains below the threshold; it is concentrated within the corporate sector which, against the background of the protracted recession, has been the main driver of a strong increase in non-performing loans. Although the unemployment indicator (3-year average) is still below the threshold, unemployment increased substantially to almost 11 per cent in 2012 and has risen further to 12¼ per cent in August 2013, while the youth unemployment and the NEET rates are very high. Poverty and social exclusion (especially severe material deprivation) have also increased markedly. *Overall, the Commission finds it useful, also taking into account the identification of imbalances in April, to examine further the risks involved in the persistence of imbalances.*

Latvia: In the previous rounds of the MIP, Latvia was not identified as experiencing imbalances. In the updated scoreboard, some indicators are beyond their indicative thresholds: NIIP and unemployment. However, both indicators are moving in the right direction and the pace of improvement is substantial. The external position remains sound, as competitiveness indicators and export market shares continue rising and the current account deficit has stabilised at low levels. While the negative NIIP remains beyond the indicative threshold, a large part of the external liabilities is composed of inward FDI, hence posing less macroeconomic risks than debt. Both the NIIP and external debt are falling relatively fast and the positive trend is expected to be sustained over the forecast horizon. On the side of internal indicators, general government sector debt remains significantly below the threshold and is forecast to fall below 40 per cent of GDP in 2015, when Latvia is scheduled to have repaid ¾ of the EU loans disbursed in 2009-11. Also private debt levels are below the threshold. House prices and credit flows are slowly recovering from the steep correction during the crisis; no big swings are expected in the medium run, as the on-going deleveraging in the household segment is projected to continue. The unemployment indicator (3-

year average) has improved marginally but the latest dynamics on the labour market are more positive and unemployment is dropping fast; the unemployment rate is now expected to move below the EU average in 2014 and below 10 per cent in 2015. The upturn in the labour market has started to contribute to the reduction in poverty and social exclusion, which remain at very high levels. *Overall, the Commission will at this stage not carry out further in-depth analysis in the context of the MIP.*

Lithuania: In the previous rounds of the MIP, Lithuania was not identified as experiencing macroeconomic imbalances. In the updated scoreboard, a few indicators are beyond their indicative thresholds, namely the NIIP and unemployment. The NIIP is markedly negative even though it has gradually improved since 2009. However, net external debt is substantially lower, as inward FDI explains a lot of the external liabilities. The current account turned to a small surplus in the first half of 2013 but is expected to return to a small deficit as domestic demand picks up further. The deficit is expected to be financed mainly through inflow of FDI and portfolio investment. Exports kept gaining market share, supported by a depreciating REER and falling ULC. However, the latter resumed growing recently on the back of revived wage increases. On the internal side, private sector debt is relatively low as is government sector debt; moreover, the latter is expected to start declining over the next years. Growth of new credit to non-financial corporates turned positive and, therefore, the deleveraging of the private sector slowed down. Housing prices have remained relatively stable over the past years. Unemployment has decreased significantly and is expected to fall below 11 per cent in 2014. The upturn in the labour market is contributing to the reduction in poverty and social exclusion, which remain at very high levels. *Overall, the Commission will at this stage not carry out further in-depth analysis in the context of the MIP.*

Luxembourg: In the previous rounds of the MIP, Luxembourg was not identified as experiencing macroeconomic imbalances. In the updated scoreboard a number of indicators are above their indicative thresholds, namely the current account surplus, unit labour costs, the private sector debt and the loss in export market shares. The very large surplus hides a persistent deficit of the trade balance. Moreover, recently losses in export market shares have become a source of concern. Not only the trade balance hit a new historical deficit, but the country has also lost market shares in (mostly financial) services since 2007. Moreover, the nominal ULC have risen substantially faster than in the euro area since 2008, and exceeds the threshold, in spite of recent measures to contain wages, and have weakened the competitive position of the domestic industry. The high private indebtedness, mainly of non-financial corporates, increases the vulnerability of enterprises and may partly be due to the existence of a bias in favour of debt rather than equity in the tax legislation. While the financial sector remains overall sound, the financial crisis has dented the growth potential of the sector and raises concerns about the impact of a less dynamic sector for both the employment and the sustainability of public finances, also taking into account costs related to an ageing population. *Overall the Commission finds it useful to conduct an in-depth analysis with a view to assessing whether imbalances exist.*

Hungary: In April 2013, the Commission concluded that Hungary was experiencing macroeconomic imbalances and indicated the necessity of adopting decisive policy actions. The very negative NIIP, in particular, raised concerns. In the updated scoreboard, this variable continues to exceed the indicative threshold by a large margin as it is above the annual GDP. In addition, indicators on losses in export market share, the government sector debt, and the unemployment rate also stay above the thresholds. As regards external imbalances, sustained current account surpluses have contributed to an improvement in the NIIP since 2009. However, the surpluses reflect the persistent weakness of domestic demand while export performance has been weak; the losses in export market shares have accelerated even if there are no strong signals of losses in cost competitiveness. This questions the sustainability of the external correction. As regards internal

imbalances, despite a sharp external adjustment reflecting the on-going private and general government sector deleveraging, important vulnerabilities remain. Against a background of policy uncertainty, the rapid fall in corporate credit has contributed to historically low investment rates, which may erode growth potential. The continuous decline in nominal house prices, together with an excessive burden on the financial sector, hinders restoring normal lending to the economy and poses risks to financial stability. General government sector debt has been slightly diminishing, but still stands significantly above the threshold; combined with a weak growth potential it makes Hungary vulnerable, which is reflected in a relatively high sovereign financing cost. The unemployment rate stands above the threshold, but youth unemployment and the severe material deprivation rate increased substantially since the start of the crisis. *Overall, the Commission finds it useful, also taking into account the identification of imbalances in April, to examine further the risks involved in the persistence of imbalances.*

Malta: In April 2013, the Commission concluded that Malta was experiencing macroeconomic imbalances arising from the significant exposure of the financial sector to the property market and the risks for the long-term sustainability of public finances. The updated scoreboard shows improvements in several areas, although a number of indicators continue to exceed their indicative thresholds, namely the depreciation in the REER, and private and general government sector debts. The external position of the economy has improved and current account indicators moved to within the threshold, while the positive NIIP increased. The depreciation in the REER to below the lower threshold, largely on account of the nominal depreciation of the euro, played a supporting role. Nevertheless, the loss in export market shares in recent years could point to an erosion of competitiveness even if the indicator measuring the 5-year change is still within its threshold. On the internal side, private debt continues to exceed the threshold, although the asset side of the private sector balance sheet appears sound. The government debt also exceeds the threshold and is on an upward path due to persistent primary deficits, while risks to the long-term sustainability of the public finances relating to the ageing population remain to be addressed. The housing market appears to have stabilised, although it continues to warrant monitoring given the interlinkages with the domestic banking sector. Concrete action to strengthen loan-loss provisioning policies is needed in view of the continued increase in non-performing loans also in the first half of 2013. *Overall, the Commission finds it useful, also taking into account the identification of imbalances in April, to examine further the persistence of imbalances or their unwinding.*

Netherlands: In April 2013, the Commission concluded that the Netherlands was experiencing macroeconomic imbalances, in particular involving the continuing adjustment in the housing market and the high level of indebtedness in the household sector. In the updated scoreboard, a number of indicators are beyond their indicative thresholds, namely the large and increasing current account surplus, the depreciation in the REER, losses in export market shares, and private and general government sector debts. On the external side, persistently large current account surpluses, well above the indicative threshold, are mainly driven by the trade balance, including positive re-exports and gas exports. The large surplus reflects high savings not absorbed by domestic investment. Looking ahead, the on-going household sector deleveraging that is needed to reduce the high household debt, together with cyclically subdued investment (particularly in the construction sector) may imply a further increase in the surplus. Moderate losses in competitiveness of domestically produced goods and services have broadly been offset by the dynamism of re-exports. The losses in export market shares are in line with those of other advanced economies at large. Risks to the economy mainly relate to the housing market and high household debt. The high mortgage debt of households relative to their disposable income is largely due to tax incentives favouring large mortgages and easy access to credit. Since the onset of the crisis, house prices have been declining and are currently showing first signs of a flattening-out. Also, recent policy changes, e.g. the legislation regarding the tax treatment of mortgages, the change from interest-only to annuity

mortgages and the stepwise reduction of the loan-to-value ratio may contribute to a gradual reduction of household debt and reduce the vulnerabilities in the financial sector in the medium term. The on-going deleveraging of households, with the household debt to GDP ratio decreasing for a few quarters already, together with negative prospects for unemployment and disposable income holds back private consumption and the impact of these measures on the financial sector require further analysis. *Overall, the Commission finds it useful, also taking into account the identification of imbalances in April, to examine further the persistence of imbalances or their unwinding.*

Austria: In the previous rounds of the MIP, Austria was not identified as experiencing imbalances. In the updated scoreboard, a few indicators exceed their indicative thresholds, namely losses in export market shares, and private and general government sector debts. There are also indications that house prices increased strongly to close or even beyond the indicative threshold in 2012. The loss in market shares mainly reflects a sharp decrease in exports towards the euro area in 2007-10. The more recent export performance, however, is broadly in line with the performance of its EU partners, and benefits from the tight supply chain integration with Germany and Central Europe. Overall, the external position was hardly impaired by the losses in market share and, on the back of resuming investment, the current account surplus stabilised at a moderate level. The NIIP remains close to zero. Moreover, the REER and ULC indicators do not point to issues with cost competitiveness. Nevertheless the decline in market shares may signal a need for better exploiting the economy's innovative capacity. On the internal side, the ratio of private debt to GDP ratio has exceeded the threshold since 2007, when non-financial corporates switched some of their financing from equity to long-term debt in a weak growth environment, but is now declining gradually. Credit flows to the private sector remain at a moderate, but positive, level. The general government sector debt continues to exceed the threshold but has not grown significantly during the crisis, and is forecast to decline from 2014. Going forward, public finances may be subject to risks linked to delays in the restructuring of the nationalised banks. Negative feedback loops between the general government and the financial sector seem contained, although the integration of the banking sector with Central European neighbours requires continued attention. *Overall, the Commission will at this stage not carry out further in-depth analysis in the context of the MIP.*

Poland: In the previous rounds of the MIP, Poland was not identified as experiencing macroeconomic imbalances. In the updated scoreboard, some indicators breach their indicative threshold, namely the current account deficit and the negative net international investment position. The current account deficit, which is slightly above the threshold, has been largely financed since 2004 through FDI inflows. It is forecast to shrink substantially in 2013 on the back of a strong improvement in the trade balance, supported by both cyclical (with weak domestic demand depressing imports) and non-cyclical factors (diversification of exports towards non-EU economies, partially compensating for recent losses in export market shares). Other factors that are likely to contribute to an improvement in the current account are the depreciation in the nominal exchange rate and the containment of nominal ULC, reflecting the weak labour market. In spite of the negative NIIP beyond the threshold, net external debt is low. Nevertheless, a growing dependence of the sovereign on foreign debt holders, exacerbated by the announced changes in the pension system, might be a source of risk. As regards internal developments, the share of private debt in GDP remains moderate. The high share of foreign currency-denominated mortgages, which was perceived as a major risk for the economy, is decreasing as the supply of new such loans was brought to a halt in 2011-2. House prices have been falling continuously since 2008, although at a moderate pace, and the repercussions on the financial sector have been contained. Wage moderation and flexible labour market regulations mitigated the increase in the unemployment rate in 2012 and first half of 2013 in the context of the sizeable economic slowdown. *Overall, the Commission will at this stage not carry out further in-depth analysis in the context of the MIP.*

Slovenia: In April 2013, the Commission concluded that Slovenia was experiencing excessive macroeconomic imbalances²³, particularly involving risks to financial stability stemming from fragile corporate balance sheets, compounded by rigidities in labour and capital markets and high state ownership that limits the adjustment capacity of the economy. In the updated scoreboard the NIIP and losses in export market shares are beyond their indicative thresholds. On the external side, a strong adjustment has taken place on the current account mainly driven by weak domestic demand, in particular falling investment, bringing the indicator to a small surplus. Nevertheless, the NIIP further deteriorated, mainly driven by valuation effects. ULC has stabilised following strong increases in the years up to 2009. The export market share has deteriorated strongly; the export dynamics is significantly worse compared to advanced economies, giving Slovenia a clear outlier status among the new EU Member States. On the internal side, the private sector debt has decreased, driven by negative credit flows to both households and non-financial corporates. Notwithstanding the fact that the private debt is below the threshold, debt is particularly weighing on firms. Their poor domestic and export revenues, combined with elevated costs of labour and capital, prevent them from generating the cash flows needed to maintain working capital and pay down debt. The adjustment in the housing market has resumed, which will depress the value of collateral held by banks. The financial sector has continued to reduce its total liabilities for a third consecutive year, as the woes of the corporate sector further deteriorate the quality of banks' credit portfolios and puts pressure on their already thin capital buffers. The government sector debt is rising rapidly and will exceed 60 per cent of GDP by end-2013, with further potential bank recapitalisations still to come. The unemployment indicator has continued increasing, leading to rising social costs of the adjustment. *Overall, the Commission finds it useful, also taking into account the identification of an excessive imbalance in April, to examine further the persistence of macroeconomic risks and to monitor progress in the unwinding of imbalances.*

Slovakia: In the previous rounds of the MIP, Slovakia was not identified as experiencing macroeconomic imbalances. In the updated scoreboard, a couple of indicators remain above the indicative thresholds: the negative NIIP and the unemployment rate. The indicator on the current account deficit (3-year average) has improved and is now only slightly negative, due to a surplus in 2012. Further improvements of the external balances are expected on the basis of strong manufacturing exports in 2013 and good expectations for 2014. The NIIP has only marginally improved in 2012 compared to 2011. Nevertheless, the external debt remains low and relatively stable, as most external liabilities are non-debt instruments. Price competitiveness developments seem benign, as the REER indicator fell, albeit less than in most euro area peers, and remains within its thresholds. Due to gains in labor productivity, nominal ULC have slightly decreased. Gains in export market shares have decelerated compared to previous years. Private sector debt has remained stable, on the back of moderately positive credit flows. The banking sector is stable and total liabilities expanded only slightly. General government sector debt has increased significantly in 2012 but remains below the threshold. House prices continued to adjust and fell for the fourth year in a row. The performance of the labour market reflects the persistence of major regional disparities in economic growth and employment. Unemployment remains the most pressing issue affecting the domestic economy. Most unemployment is long-term, which suggests its nature is structural rather than cyclical and constitutes a vulnerability. Youth unemployment is also a serious problem with the sixth highest youth unemployment rate in the EU. *Overall, the Commission will at this stage not carry out further in-depth analysis in the context of the MIP.*

²³ However, the corrective arm of MIP was not triggered given the ambition of the Slovenian national reform programme and stability programme. The Commission is closely monitoring the implementation of the policy reforms and compliance with the MIP-relevant recommendations adopted by the Council in July. This monitoring shows that over the last months, there has been a stepping up of the pace of structural reforms relevant for the adjustment of imbalances, with crucial progress being achieved in the area of the banking sector.

Finland: In April 2013, the Commission concluded that Finland experienced macroeconomic imbalances, in particular as regards developments related to competitiveness. In the updated scoreboard, a number of indicators are above the indicative thresholds, namely the depreciation in the REER, losses in export market shares and the level of private sector debt. The most pressing issues remain on the external side. Finland has been continuously losing market shares at the fastest pace in the EU. Losses have also been large when comparing with the performance of advanced countries at large. Although most losses took place in 2009-10, the export losses are still continuing. The current account, traditionally in surplus, has been in deficit since 2011 and continued its decline in 2012. Cost competitiveness through high growth in ULC over a longer period of time plays a role even if the indicator fell below the threshold in 2012. Also losses in terms of trade are noticeable. At the same time the HICP-deflated REER depreciated in 2009-12, to a large extent driven by the nominal exchange rate of the euro. Nevertheless, over the same time period the REER has appreciated slightly compared with the euro area countries. On the internal side, the private sector debt to GDP ratio remains above the threshold, dominated by corporate debt, and further increased in 2012, partly due to the contraction in GDP. The growth in liabilities of the financial sector has normalised, supporting the finding in the previous round of the MIP that it was due to unique circumstances arising from the structure of the Nordic financial markets. The decline in real house prices has continued in 2012, decreasing the risks from overheating in the housing market. *Overall, the Commission finds it useful, also taking into account the identification of imbalances in April, to examine further the persistence of imbalances or their unwinding.*

Sweden: In April 2013, the Commission concluded that Sweden experienced macroeconomic imbalances, in particular as regards private sector debt and deleveraging, coupled with inefficiencies in the housing market. In the updated scoreboard, a number of indicators are above their indicative thresholds, namely the current account surplus, the losses in export market shares and private sector debt. As regards the external position, Sweden is marked by indicators pointing in opposite directions. The losses in export market shares decelerated slowly in 2010-1, but re-accelerated in 2012 and are well above the indicative threshold. When compared to advanced economies, Sweden has also lost market shares but to a lesser extent. Domestic prices and labour cost developments cannot explain this fully as prices and ULC have been growing more slowly than in the main trading partners. However, the REER has appreciated since 2010 due to the strong krona. In the meantime, Sweden has recorded sizeable current account surpluses since 2001. On the internal side, the high private debt continues to deserve attention while government sector debt is relatively low. Corporate debt adjusted somewhat in 2009-12 but remains high. Due to a slowdown in credit growth, caused by a loan to value cap of 85 per cent on mortgages, household debt levels have been stabilising since 2010 but remain high. House prices have stabilised in 2011-2 at high levels. Despite some recent measures, the housing market is still prone to unfavourable developments. Housing supply remains constrained by cumbersome planning processes, limited competition within the construction sector and regulation of rental markets. Together with a debt-biased housing taxation, these inefficiencies tend to push house prices and household indebtedness up, implying risks for macroeconomic stability. In the short to medium term, corporate debt is expected to decrease, following on recent reforms in company taxation, whereas household debt and nominal house prices are likely to grow moderately. The risks for banks appear overall contained but the high level of household debt makes Swedish banks more vulnerable to a loss in confidence if house prices drop markedly. *Overall, the Commission finds it useful, also taking into account the identification of imbalances in April, to examine further the persistence of imbalances or their unwinding.*

United Kingdom: In April 2013, the Commission concluded that the UK was experiencing macroeconomic imbalances, in particular regarding household debt, the housing market and external competitiveness. In the updated scoreboard some indicators are above the indicative

threshold, namely the losses in export market shares, and private and government sector debts. On the external side, the current account indicator has deteriorated further but remains within the threshold. The current account deficit of close to 4 per cent of GDP in 2012 may have been driven by temporary factors, namely a weakness in the income balance and the disruption in oil production and unfavourable conditions in trading partners. The NIIP remains slightly negative, although with an improvement in 2011-2. The losses in export market shares have decelerated in 2012. While there have been signs of a gradual improvement in the second half of 2012, important structural challenges still confront the UK in improving its trade performance. These include the need to boost productivity and non-cost competitiveness of the goods-producing sector, and recuperating the pre-crisis dynamism of service exports. On the internal side, private sector debt is still considerably above the indicative threshold. Both households and non-financial corporations deleverage at a very slow pace, while credit flows remain slightly positive. Household deleveraging may lose momentum because of a pick-up in house price, driven by a combination of persistently tight housing supply and policies that are likely to revive demand. Recent data show a steady rise in mortgage approvals and signs of an increase in nationwide prices. The high and increasing level of government sector debt remains a concern as it has increased substantially in 2009-12. On current trends, government sector debt is expected to increase in the short term but should fall back thereafter as growth picks up and if the deficit declines. Finally, the on-going balance sheet repair of the financial sector and the persistent scarcity of credit for smaller firms may continue to hold back economic growth. *Overall, also taking into account the identification of imbalances in April, the Commission finds it useful to examine further the persistence of imbalances or their unwinding.*

Box 1: Surveillance of current accounts surpluses in the MIP²⁴

The surveillance in MIP covers both current account deficits and surpluses. However, the nature, importance and urgency of the policy challenges differ significantly depending on the Member States concerned. Given the vulnerabilities and magnitude of the adjustment required, the need for policy action is particularly pressing in Member States showing persistently large current account deficits and competitiveness losses. Persistent *surpluses* may be justified by fundamentals. Nevertheless, large and persistent current account *surpluses* can also be caused by market failures or policy settings that constrain domestic demand and investment opportunities. However, current account *surpluses* do not raise concerns about the sustainability of external debt or financing capacity.¹

Current account deficits and surpluses are not necessarily macroeconomic imbalances in the sense of developments which are adversely affecting, or have the potential to affect the proper functioning of economies, of the monetary union, or on a wider scale. Deficits and surpluses are a natural consequence of economic interactions between countries. They show to which extent a country relies on borrowing from the rest of the world or how much of its resources it lends abroad. In this way, external borrowing and lending allows countries to trade consumption over time: a country with a current account *surplus* transfers consumption from today to tomorrow by investing abroad. In turn, a country with a current account deficit can increase its consumption or investment today but must transfer future income abroad to redeem its external debt. Deficits and *surpluses* can thus simply be the result of an appropriate allocation of savings, taking into account different investment opportunities across countries. Differences in economic prospects lead to differences in saving behaviour, with brighter expectations reducing the tendency of economic agents to save and hence contributing to the accumulation of deficits. In particular, countries with a rapidly ageing population may find it opportune to save today (*i.e.* run surpluses) to smooth consumption over time.

Current account deficits and surpluses are part of the adjustment process in a monetary union. They absorb asymmetric shocks in the absence of independent monetary policy and nominal exchange rate adjustment. Market-driven changes in cost and price competitiveness facilitate adjustment, with competitiveness losses taking place in overheating economies and gains in countries in cyclical downturn and with high unemployment. Besides cyclical swings, structural factors also play a role. Catching-up countries with higher growth prospects tend to run current account deficits as they borrow resources from abroad, which also lead to trend appreciations in their real exchange rates. Such 'downhill' financial flows from the core EU economies to the periphery are a normal feature of savings looking for the highest return. External imbalances, however, may be problematic if they become entrenched, either due to structural shifts in the economy or due to mispricing of the risks and overestimating the expected returns.

Surpluses can be the result of distortions due to incorrect expectations, mispricing of risks, market distortions or if they reflect misguided policy interventions or weaknesses in financial supervision. These market or policy failures imply a misallocation of resources and a build-up of imbalances and vulnerabilities in both surplus and deficit countries. The misallocation of resources will entail welfare losses also in the *surplus* countries. In these cases, it would be in the self-interest of the surplus countries to reduce their *surpluses*, by removing the obstacles hampering their domestic demand. The large valuation losses sustained by some *surplus* countries since the start of the financial crisis due to inefficient investment of their excess savings signal that the expectations on future returns on investment were inflated and imply a reduction in the expected consumption opportunities and a welfare loss. To avoid these inefficiencies it is important to ensure that financial markets make decisions on the basis of properly risk-adjusted returns on investment and that appropriate macro-prudential supervision is in place to prevent excessive concentration of risks in both capital-originating and -receiving countries. The predominance of debt instruments in financing deficits in vulnerable countries was a particular factor that contributed to the concentration of risks.

The negative implications of excessive current account deficits and surpluses affect both the country concerned and its partners. This is particularly so in a monetary union, where the single exchange rate and the common monetary policy cannot respond to adjustment needs of individual economies. If a large share of a monetary union increases savings or reduces investment, and therefore increases its *surplus* and exports capital, the current account deficit in the rest of the monetary area will most likely deteriorate: either through bilateral financial flows, or through the impact on the common exchange rate. Unless the real effective exchange rate appreciates in the surplus countries due to relatively stronger increases in wage and price levels, the nominal exchange rate of the euro will tend to appreciate. This may have competitiveness and deflationary effects on the rest of the area, particularly in countries whose exports are more price-sensitive. In this respect, the current accounts of the euro area countries as a whole, but also of each one of them individually, are issues of common interest.

It is not possible to establish causality between deficits and surpluses in any pair of countries; but deficits and surpluses in the euro area (and EU) are closely connected due to intensive cross-border trade and financial links. In particular, the excess savings of the *surplus* countries financed deficits in the euro-area periphery. Moreover, some of the core economies intermediated large financial flows from non-EU investors into the EU periphery countries. In the

²⁴ This box is an extract of the main findings of 'Current Account Surpluses in the EU,' *op.cit.*

absence of adequate financial supervision, which would have helped to identify and limit the risks involved, this resulted in credit-driven booms, reductions in savings and excessive investment in non-productive activities in the periphery, and excessive risk concentration in the financial systems of the core countries. A spatial correlation analysis confirms that, in the EU, a country is more likely to run a deficit in its financial account if its major financial partners run surpluses, and vice versa. On the other hand, spillovers through bilateral trade relations are dominated by positive interactions between countries closely integrated in supply chains: a country is more likely to run a trade *surplus*, if its major partners also run *surpluses*. There is no evidence that the export performance of the surplus countries significantly crowded out the exports of the euro-area periphery.

An increase in demand in the euro-area *surplus* economies would improve the trade balance of the euro area peripheral economies. However, the impact of such a development on the rebalancing of *surpluses* and deficits and on the economic activity of the deficit economies should not be overestimated. *First*, given the sectorial and geographical links, an increase in domestic demand of a big surplus country, such as Germany, has a much stronger impact on the exports of the neighbouring countries, including those with a surplus, rather than in the EU peripheral economies. However, this impact could be larger if the increase in demand also applied to the other surplus economies. *Second*, the impact would be stronger if such an increase in demand (and reduction in the trade balance) of the *surplus* countries took place in parallel with a weakening of the euro exchange rate.

Box 2: What is an imbalance?

Regulation (EC) No 1176/2011 on the prevention and correction of macroeconomic imbalances defines a macroeconomic imbalance as '*any trend 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 States or of the economic and monetary union or of the Union as a whole,*' while the excessive imbalances are '*severe imbalances that jeopardise of risk jeopardising the proper functioning of the economic and monetary union.*'

In general, any deviation from a desirable level can be considered as an imbalance. However, not all imbalances are worrisome or require policy interventions as they may be part of the economy's dynamic adjustment. Imbalances that require close monitoring and possibly policy interventions relate to developments that could significantly impede the proper functioning of the economy of a Member State, the euro area or the EU. In practice, imbalances require close monitoring if they are either at dangerous levels (*e.g.* high debts) or reflect unsustainable dynamics (*e.g.* very dynamic house prices or credit), that threaten to result in abrupt and large, and hence damaging, adjustment. For example, having a large and persistent current account deficit is considered an imbalance if it runs the risk of leading to a 'sudden stop' and large welfare costs.

The extent of an imbalance refers to the degree of obstructing the smooth functioning of economic activity and to the risk of an abrupt adjustment, that is, the likelihood of an adjustment occurring within a given period. In general, one can refer to any economic variable and evaluate their probability of a large change (or of a change in a combination of them) in the next period. For example, the probability that the current account deficit or house prices will decline by given percentage points during the next year. In most cases, however, one is mainly concerned about the implications to an abrupt adjustment to economic activity and employment.

The theoretical and empirical literature provides background for identifying variables that depict imbalances. Theoretical models have provided underpinning for evaluating whether developments are unsustainable and hence constitute an imbalance. Empirical studies have helped improve the theoretical model and highlight the values that may reflect and suggest unsustainable developments. While this set of variables captures qualitatively imbalances quite well, the difficulty lies in providing more quantitative evaluations. That is, qualitatively one can say that if a country runs unsustainable dynamics such as a persistent and large current account deficit, it is likely to face an abrupt adjustment at some point. However, the exact timing and transmission is much more difficult to gauge.

Against this background, when identifying risks of potential imbalances and selecting Member States for an IDR, the following broad principles have guided the Commission's work in the reading of the scoreboard and its auxiliary indicators:

External debt sustainability: The key scoreboard indicators are the NIIP (stock) and the current account deficit/surplus (flow). A large negative NIIP and a large current account deficit are reasons for particular concern. In case of negative NIIP, it should be qualified by the net external debt to cater for inward FDI stocks, as those liabilities raise fewer risks than debt²⁵. Surpluses do not raise the same risks as deficit, but they may also be imbalances if they are excessive and reflect market or policy distortions which lead to misallocation of resources and welfare losses in the country or in its partners.

Trade performance and competitiveness: The key scoreboard indicator is the export market shares, but also the price competitiveness indicators, REER and nominal ULC. Weak trade performance and losses in competitiveness are concerns by themselves, in particular if there are also external sustainability issues, a need for a more positive external performance to support a wider deleveraging effort or reallocation of resources. Relevant auxiliary indicators are the net trade balance of energy products²⁶, change in REER in relation to the euro area, and alternative ULC indicators. An indicator on the export performance relative to the advanced economies is also useful. In addition, aspects related to non-price competitiveness could be taken into account as qualifiers such as information on product and geographical specialisation, although these issues are in principle to be considered in the subsequent steps of the MIP. Developments in trade performance and competitiveness need to be interpreted at the light of the sustainability issues. Although the

²⁵ When looking into year-to-year developments of the NIIP and external debt, one should take into account that these variables are measured at market value: an improvement or deterioration of these variables may depend as much on an improvement (or deterioration) of the fundamentals, as well as on the market perceptions of the countries' creditworthiness.

²⁶ See in this respect 'Member States' Energy Dependence: An Indicator-Based Assessment,' *European Economy-Occasional Papers*, 145, and 'Energy Economic Developments in Europe,' *European Economy*, (forthcoming).

reduction in very large surpluses is not to be expected to take place fundamentally through reduction in exports and losses in market shares, a loss in market shares in a country in deficit, with very negative NIIP or with a recent deep deterioration of the current accounts balance cannot be interpreted in the same manner as a loss in market shares in countries in surplus.

Private sector indebtedness, deleveraging and credit: The scoreboard has been designed to identify excessive leverage and credit growth. Given the current economic situation, the focus has shifted to deleveraging pressures (*i.e.* high stocks of debt, and not so much on excessive credit flows). This is captured by looking at the stock of private sector debt, acknowledging the distinction between households and non-financial corporations, and the dynamics of their debt, and the interaction with general government liabilities. The stock of sectorial debts can be qualified by looking at both consolidated and non-consolidated figures (to take into account domestic intra company loans). Private sector deleveraging pressures should also be qualified taking into account their interaction with the general government sector²⁷, with regard to the combined impact on economic activity.

Financial sector risks for the real economy: The scoreboard indicator is the growth rate of financial sector liabilities while a leverage indicator appears among the auxiliary indicators. Since the aim is to capture the increases of financial sector-related risks and the way they could amplify shocks in the real economy, the two indicators should be assessed together. Exposure to sovereign debt or risks from excessive private debt (mortgages and link with house prices) are highly relevant. Highly-leveraged sectors can signal an overexpansion of the banks' balance sheet, feeding credit bubbles and amplifying any unfavourable economic development.

Unemployment: The unemployment rate appears in the scoreboard as a contextual variable, which helps understanding the interaction between the several areas of an economy pointing towards misallocation of resources (mismatch) and general lack of adjustment capacity.

Housing and mortgage markets: Key objectives are to capture the risk of house price bubbles building up and the risks stemming from large additional corrections, including implications of negative equity positions of households and on growth conditions through wealth effects. The main indicator is the yearly change of real house prices put in perspective of accumulated price changes. Different indicators of over/under-valuation can be used as supporting evidence, although these are not part of the scoreboard. The risks from further adjustment need to be qualified by the level of household debt and interlinkages with the financial system. The supply of credit is relevant in this context. In some cases, it can also be relevant to take into account adjustment pressures from the supply side. Given the financial circumstances of the several Member States, the objective should not only be understanding whether there are housing bubble building up, but also how the deflating of bubbles is progressing and risks of either slow or excessively fast developments.

²⁷ On the government debt sustainability, see 'Fiscal Sustainability Report-2012,' *European Economy*, 2012 (8). For a detailed description of fiscal surveillance, see 'Report on Public Finances in EMU,' *European Economy*, 2013 (3).

Table A1. Scoreboard indicators and their 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 41 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 (consolidated) as % of GDP (d), (e)	Unemployment rate - 3-year average	Private sector debt (consolidated) as % of GDP (d), (e)	General government sector debt as % of GDP	y-o-y % change in total financial sector liabilities, non-consolidated data
Data source	EUROSTAT (Balance of Payments statistics)	EUROSTAT (Balance of Payments Statistics)	DG ECFIN (data base Price and Cost competitiveness).	EUROSTAT (Balance of Payments Statistics)	EUROSTAT (National Accounts)	EUROSTAT	EUROSTAT (National Accounts)	EUROSTAT (Labour Force Survey)	EUROSTAT (National Accounts)	EUROSTAT (EDP – treaty definition).	EUROSTAT (National Accounts)
Indicative thresholds	-4/+6% Lower quartile (also used as a reference for upper threshold)	-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 €A +3%	+6% Upper quartile	+15% Upper Quartile	+10%	133% Upper Quartile	+60%	16.5%
Some additional indicators to be used in economic reading	Net lending/borrowing vis-à-vis ROW as % of GDP	Net External Debt as % GDP Inward FDI flows and stocks as % of GDP	Real effective exchange rate vis-à-vis rest of the euro area	Relative export market shares relative to advanced economies; Labour productivity; Trend TFP growth	Nominal unit labour costs (changes over 1, 5, 10 years); Effective unit labour cost relative to the rest of euro-area	Real house price changes (cumulated over 3 years); Nominal house price index Value-added in residential construction	Change in private debt	Participation rate, long-term and youth unemployment poverty indicators	Private sector debt based on non-consolidated data		Debt over equity ratio

Notes: (a) For EU trading partners HICP is used while for non-EU trading partners, the deflator is based on a CPI; (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; (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.

Table A2. MIP scoreboard 2012

Year 2012	External Imbalances and Competitiveness									Internal		
	Current Account Balance as % of GDP		Net International Investment Position as % of GDP	Real Effective Exchange Rate (42 IC - HICP deflators)		Export Market Shares		Nominal ULC		% y-o-y change in Deflated House Prices	Private Sector Credit Flow as % of GDP, consolidated	Private Sector Debt as % of GDP, consolidated
	3 year average	p.m.: level year 2012		% change (3 years)	p.m.: % y-o-y change	% change (5 years)	p.m.: % y-o-y change	% change (3 years)	p.m.: % y-o-y change			
Thresholds	-4/+6%	-	-35%	±5% & ±11%	-	-6%	-	+9% & +12%	-	+6%	14%	133%
BE	-0.4	-2.0	48	-4.3	-2.3	-14.9	-5.2	6.6	4.1	-0.2	-1.5	146
BG	-0.9	-1.3	-80	-4.0	-2.0	4.8	-5.5	7.4	-0.5	-5.3 (p)	2.5	132
CZ	-3.0	-2.4	-50	0.4	-2.8	-4.2	-4.6	3.9	3.8	-3.9	0.6	72
DK	5.9	6.0	38	-7.7	-2.8	-18.6	-4.8	1.0	1.6	-5.1	6.1	239
DE	6.5	7.0	42	-8.9	-3.2	-13.1	-4.6	3.0	3.1	1.8	1.5	107
EE	0.9	-1.8	-54	-3.4	-0.6	6.5	-4.1	-2.8	4.2	3.5	4.7	129
IE	2.3	4.4	-112	-12.2	-4.3	-16.3	-3.3	-10.4	0.0	-11.7	-1.6	306
EL	-7.5	-2.4	-109	-4.5	-3.9	-26.7	-7.3	-8.1	-6.2	-12.4 (1)	-6.8	129
ES	-3.1	-1.1	-93	-5.2	-2.3	-14.6	-4.9	-5.6	-3.0	-16.9	-10.5	194
FR	-1.8	-2.2	-21	-7.8	-3.2	-14.0	-6.8	4.1	2.1	-2.3	3.5	141
HR	-0.5	0.0	-89	-8.3	-2.6	-24.7	-7.4	0.8	1.2	-2.4	-2.1	132
IT	-2.3	-0.4	-25	-6.2	-1.8	-23.8	-5.0	3.1	2.3	-5.4 (p)	-1.0	126
CY	-6.7	-6.9	-82	-5.8	-1.9	-26.6	-9.4	0.8	-2.7	-2.2	10.0	299
LV	-0.6	-2.5	-67	-8.5	-1.4	12.3	5.4	-5.8	3.4	-0.6	-1 (p)	91.7 (p)
LT	-1.3	-0.2	-53	-6.7	-2.0	29.3	5.7	-4.6	1.9	-3.2	-0.3	63
LU	7.0	6.6	169	-2.3	-1.4	-18.3	-4.0	9.8	4.7	2.5	-5.0	317
HU	0.6	1.0	-103	-1.2	-2.3	-17.8	-7.4	4.4	2.7	-9.2	-6.1	131
MT	-1.6	1.6	25	-7.7	-2.1	4.5	-1.9	4.9	3.7	0.3	-1.6	155
NL	8.8	9.4	47	-6.0	-1.8	-12.0	-3.3	3.3	2.8	-8.7	0.2	219
AT	2.2	1.6	0	-4.7	-1.7	-21.2	-6.3	4.1	3.0	na (2)	2.7	147
PL	-4.6	-3.7	-67	1.3	-2.3	1.3	-2.7	4.4	2.0	-5.9 (e)	3.4	75
PT	-6.5	-2.0	-115	-4.0	-1.5	-16.0	-5.3	-5.3	-3.1	-8.6 (p)	-5.4	224
RO	-4.4	-4.4	-68	-1.9	-6.0	5.9	-7.1	4.8	6.5	-9.2	0.9	73
SI	1.2	3.3	-45	-4.5	-1.2	-19.9	-6.9	0.4	0.8	-8.4	-2.9	114
SK	-1.7	2.2	-64	-3.2	0.0	4.2	1.5	0.9	1.0	-5.9	3.2	73
FI	-0.5	-1.7	18	-8.3	-2.7	-30.8	-7.1	4.8	4.4	-0.5 (p)	9.0	158
SE	6.2	6.0	-10	10.1	-0.8	-18.8	-6.0	0.7	2.9	-0.2	1.8	212
UK	-2.8	-3.8	-9	5.8	4.3	-19.0	-1.7	6.1	3.0	-0.9	2.6	179

Source: EUROSTAT, DG ECFIN (for the indicators on the REER).

Note: (1) Eurostat estimate based on HPI data from Bank of Greece produced in agreement with ELSTAT. (2) HPI data up until 2011 by Statistics Austria. For 2012, Eurostat harmonised HPI data by ECB & Central Bank of Austria. (3) Eurostat expressed a reservation on Austrian general government sector debt, see Eurostat press release 152/2012.

Table A3.: Auxiliary indicators used in the economic reading of the MIP scoreboard, 2012

Year 2012	% y-o-y change in real GDP	Gross Fixed Capital Formation as % GDP	Gross Domestic Expenditure on R&D as % GDP	Net Lending / Borrowing as % GDP, BoP data	Net External Debt as % GDP	Inward FDI Flows as % GDP	Inward FDI Stocks as % GDP	Net Trade Balance of Energy Products as % GDP	% Change (3 years) in REER vs. EA	% change (5 years) in Export Performance vs. Advanced economies	% change (5 years) in Terms of Trade	% y-o-y change in Export Market Shares, goods and services volume	% y-o-y change in Labour Productivity	% Change (10 years) in Nominal ULC	% change (10 years) ULC performance relative to EU
BE	-0.1	20.4	0.0	-2.1	-93.7	-7.6	195.3	-5.3	1.9	-6.0	-2.1	-3.6	-0.3	22.0	5.2
BG	0.8	21.4	0.0	0.0	28.8	3.7	95.2	-7.3	1.8	15.8	2.4	-2.8	3.4	70.5	45.1
CZ	-1.0	23.1	0.0	-1.1	-1.3	5.4	67.6	-4.9	5.5	5.8	-3.6	2.8	-1.4	18.5	4.1
DK	-0.4	17.1	0.0	6.0	12.0	0.9	32.4	0.5	0.7	-10.0	2.1	-8.8	-0.1	27.2	8.1
DE	0.7	17.6	0.0	7.0	-9.4	0.2	28.5	-3.9	-1.2	-4.0	-2.2	1.1	-0.4	7.6	-11.1
EE	3.9	25.2	0.0	1.7	-2.0	6.8	84.2	-1.4	5.2	17.7	-3.4	3.1	1.7	67.3	42.1
IE	0.2	10.7	0.0	3.2	-396.7	18.2	157.1	-3.2	-5.1	-7.5	-4.4	0.3	0.8	15.4	-2.1
EL	-6.4	13.1	0.0	-1.2	121.5	0.7	9.7	-3.9	2.0	-19.0	-3.8	-2.9	2.1	11.6	-4.1
ES	-1.6	19.2	0.0	-0.5	90.3	2.0	46.8	-3.9	0.8	-5.6	-5.3	0.5	2.7	18.6	0.5
FR	0.0	19.8	0.0	-2.2	35.0	1.0	40.8	-3.3	-0.5	-5.0	-2.4	-0.1	0.1	20.9	4.1
HR	-2.0	18.4	0.0	0.1	79.5	2.4	54.9	-6.0	-2.5	-16.8	2.5	-2.1	2.0	31.7	11.1
IT	-2.5	17.9	0.0	-0.1	55.5	0.0	17.6	-3.9	1.3	-15.7	-4.3	-0.2	-2.2	27.6	10.1
CY	-2.4	13.7	0.0	-6.7	36.7	5.5	90.0	-8.3	2.0	-18.9	-1.6	-0.2	1.8	28.1	11.1
LV	5.0	22.8	0.0	0.5	38.9	3.9	46.5	-6.0	-0.7	24.2	-1.3	4.6	3.4	100.8	66.1
LT	3.7	16.6	0.0	2.0	33.6	1.7	36.7	-8.4	1.5	42.9	-2.6	8.6	1.9	32.1	11.1
LU	-0.2	19.3	0.0	6.1	-2444.8	523.6	4311.5	-6.5	2.8	-9.7	3.1	-5.8	-2.6	37.0	17.1
HU	-1.7	17.4	0.0	3.6	57.1	11.1	80.8	-6.4	4.4	-9.1	-2.3	0.0	-1.8	39.3	23.1
MT	0.8	14.8	0.0	2.9	-176.4	-0.4	180.7	-12.8	1.0	15.5	-1.4	2.6	-1.5	28.3	11.1
NL	-1.2	17.0	0.0	7.8	32.5	1.5	77.3	-2.6	-0.3	-2.7	-1.6	0.8	-1.1	17.8	0.1
AT	0.9	21.4	0.0	1.5	25.6	1.5	65.4	-4.1	1.3	-12.9	-4.3	-0.8	-0.4	16.6	0.9
PL	1.9	19.1	0.0	-1.5	36.1	1.2	45.7	-3.5	7.1	12.0	-2.8	-0.1	5.6	9.1	-5.1
PT	-3.2	16.0	0.0	0.3	102.3	4.2	55.0	-4.7	0.9	-7.2	-0.1	-5.1	1.1	11.5	-4.1
RO	0.7	26.7	0.0	-3.0	40.2	1.6	44.6	-3.1	3.2	17.1	10.5	-5.7	-0.8	144.0	107.1
SI	-2.5	17.8	0.0	3.0	41.2	-0.1	33.2	-6.9	0.3	-11.5	-4.3	-2.3	-1.7	32.0	13.1
SK	1.8	20.1	0.0	4.2	22.4	3.1	59.5	-5.9	1.9	15.1	-5.6	6.1	1.7	23.7	7.1
FI	-0.8	19.6	0.0	-1.6	36.4	1.4	38.0	-2.7	1.6	-23.5	-5.7	-3.9	-0.8	26.5	7.1
SE	1.0	19.0	0.0	5.9	60.1	3.1	64.0	-1.7	19.1	-10.2	-1.3	-8.4	0.2	11.3	-5.1
UK	0.1	14.3	0.0	-3.6	31.7	2.5	53.7	-1.2	14.4	-10.5	-3.6	-2.9	-1.1	29.4	na

Source: EUROSTAT, DG ECFIN (for the indicators on the REER vis-à-vis EA and Effective ULC vis-à-vis EA) and IMF WEO (for the indicator on export market share in EU)

Note: b= break in time series, p= provisional data, e= estimated.

Table A3 (continued): Auxiliary indicators used in the economic reading of the MIP scoreboard, 2012

Year 2012	% y-o-y change in employment	Activity Rate (15-64 years)		Long-term Unemployment Rate (% of active population)		Youth Unemployment Rate (% of active population in the same age group)		Young People not in Employment, Education or Training (% of total population)		People At-risk Poverty or Social Exclusion (% total population)		At-risk Poverty Rate (% of total population)		Severe Material Deprivation Rate (% of total population)	
		level	% point change (3 years)	level	% point change (3 years)	level	% point change (3 years)	level	% point change (3 years)	level	% point change (3 years)	level	% point change (3 years)	level	% point change (3 years)
BE	0.2	66.9	0.0	3.4	-0.1	19.8	-2.1	12.3	1.2	na	na	na	na	na	na
BG	-2.5	67.1	-0.1	6.8	3.8	28.1	13.0	21.5	2.0	49.3	3.1	21.2	-0.6	44.1	2.2
CZ	0.4	71.6	1.5	3.0	1.0	19.5	2.9	8.9	0.4	15.4	1.4	9.6	1.0	6.6	0.5
DK	-0.3	78.6	-1.6	2.1	1.5	14.0	2.2	6.6	1.2	19.0	1.4	13.1	0.0	2.8	0.5
DE	1.1	77.1	0.8	2.5	-1.0	8.1	-3.1	7.7	-1.1	19.6	-0.4	16.1	0.6	4.9	-0.5
EE	2.2	74.9	0.9	5.5	1.7	20.9	-6.6	12.5	-2.4	23.4	0.0	17.5	-2.2	9.4	3.2
IE	-0.6	69.2	-1.4	9.1	5.6	30.4	6.4	18.7	0.3	na	na	na	na	na	na
EL	-8.3	67.9	0.1	14.4	10.5	55.3	29.5	20.3	7.7	34.6	7.0	23.1	3.4	19.5	8.5
ES	-4.2	74.1	1.1	11.1	6.8	53.2	15.4	18.8	0.5	28.2	3.7	22.2	2.1	5.8	1.3
FR	0.0	71.0	0.5	4.1	0.7	24.7	0.7	12.2	-0.2	19.1	0.6	14.1	1.2	5.3	-0.3
HR	-3.9	60.5	-1.9	10.3	5.2	43.0	17.9	16.7	4.8	32.3	na	20.5	2.6	15.4	na
IT	-0.3	63.7	1.3	5.7	2.2	35.3	9.9	21.1	3.4	30.4 (p)	5.7 (p)	19.8	1.4	14.5	7.5
CY	-4.2	73.5	0.5	3.6	3.0	27.8	14.0	16.0	6.1	27.1	3.6	14.7	-1.1	15.0	5.5
LV	1.6	74.4	0.5	7.8	2.9	28.5	-4.8	14.9	-2.5	36.6	-0.8	19.4	-6.3	26.0	4.1
LT	1.8	71.8	2.0	6.6	3.4	26.7	-2.3	11.1	-1.3	32.5	3.0	18.6	-2.0	19.8	4.7
LU	2.5	69.4	0.7	1.6	0.4	18.0	1.5	5.9	0.1	18.4	0.6	15.1	0.2	1.3	0.2
HU	0.1	64.3	2.7	4.9	0.7	28.1	1.6	14.7	1.3	32.4	2.8	14.0	1.6	25.7	5.4
MT	2.3	63.1	4.0	3.0	0.0	14.2	-0.2	11.1	1.3	22.2	2.0	15.0	-0.3	8.0	3.3
NL	-0.2	79.3	-0.4	1.8	0.9	9.5	1.8	4.3	0.2	15.0	-0.1	10.1	-1.0	2.3	0.9
AT	1.3	75.9	0.6	1.1	0.1	8.7	-1.3	6.5	-1.3	na	na	na	na	4.0	-0.8
PL	-3.4	66.5	1.8	4.1	1.6	26.5	5.9	11.8	1.7	26.7	-1.1	17.1	0.0	13.5	-1.5
PT	-4.2	73.9	0.2	7.7	3.0	37.7	12.9	14.1	2.9	25.3	0.4	17.9	0.0	8.6	-0.5
RO	1.5	64.2	1.1	3.2	1.0	22.7	1.9	16.8	2.9	41.7	-1.4	22.6	0.2	29.9	-2.3
SI	-0.8	70.4	-1.4	4.3	2.5	20.6	7.0	9.3	1.8	19.6	2.5	13.5	2.2	6.6	0.5
SK	0.1	69.4	1.0	9.4	2.9	34.0	6.4	13.8	1.3	20.5	0.9	13.2	2.2	10.5	-0.6
FI	0.0	75.2	0.2	1.6	0.2	19.0	-2.5	8.6	-1.3	17.2	0.3	13.2	-0.6	2.9	0.1
SE	0.7	80.3	1.4	1.5	0.4	23.7	-1.3	7.8	-1.8	18.2	2.3	14.2	0.9	1.3	-0.3
UK	1.2	76.3	0.6	2.7	0.8	21.0	1.9	14.0	0.7	na	na	na	na	na	na

Source: EUROSTAT.

Note: p= provisional data.