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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROGROUP

2016 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011

{SWD(2016) 71 to SWD(2016) 96}

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1. INTRODUCTION

The European Semester is an important vehicle for delivering reforms at national and EU level. It provides focus and coordination to the efforts of all Member States on macroeconomic, budgetary and structural reforms. Following the Commission Communication on steps towards Completing Economic and Monetary Union[1], the 2016 European Semester takes forward the streamlined process initiated in 2015. It integrates the euro area and national dimensions, and puts a stronger focus on employment, social performance, investment and competitiveness. It promotes convergence and recognises the support to reforms from European funds, in particular the European Structural and Investment Funds, and technical assistance.

In the Annual Growth Survey 2016[2], the Commission put emphasis on the need to consolidate the recovery, set it on a sustainable path and to accelerate the process of upward convergence. Euro area challenges and priorities were also spelled out in the recommendation on the economic policy of the euro area.[3] Pursuing upward economic and social convergence is essential to tackle the disparities between and within Member States. In this light, the Commission invited Member States to take advantage of the ongoing moderate recovery to focus policy efforts on the three following priorities: re-launching investment, pursuing structural reforms to modernise EU economies and responsible fiscal policies.

The country reports under the 2016 European semester have been issued at a time when it is crucial to nurture the economic recovery and ensure that it is supported by the necessary measures and policies to unlock further growth. The reports demonstrate that Member States are making efforts in this regard. While some reforms may take years to bear fruit, over time structural reforms will provide further basis for sustainable growth, a competitive economy, jobs and investment. Given the speed of potential change in macroeconomic conditions in a globalised economy, it is urgent to make the best use of the current factors conducive to growth and accelerate the pace of reforms to foster the European Union's competitiveness. Economic and social policies will also need to cater for the recent inflow of migrants and refugees, in particular to provide for their immediate needs and integration in the labour market.

The close involvement of national Parliaments, social partners, civil society and other stakeholders in the design and implementation of reforms is key to successful outcomes. It is necessary to strengthen effectiveness and ownership of reform efforts in the Member States. This is reflected in the guidance that the Commission has provided to the Member States on the process of preparation of the National Reform Programmes. The Commission has also developed closer contacts with the social partners at European and national levels to discuss the main milestones of the European Semester. The commitment of civil society to the implementation of the Europe 2020 strategy should also be built upon further.

The country reports produced for 26 Member States[4] give a view of the overall economic and social developments in each Member State. The reports assess the progress made in addressing the issues identified in the 2015 country-specific recommendations and – for 18

[1] COM (2015) 600.
[2] COM (2015) 690.
[3] Council document 14860/1/15 REV 1, as endorsed by the European Council of 18-19 February 2016.
[4] Apart from Greece and Cyprus, which are subject to macro-economic assistance programmes.

Member States – include the in-depth review under the macroeconomic imbalances procedure. On the basis of this analysis, the Commission proposes to update the status of a number of Member States under that procedure. The reports also cover areas of

macroeconomic importance, such as climate and energy policies, that are subject to separate policy processes[5].

The analysis also takes stock of the budgetary situation of the Member States. It is based on the Commission's latest economic forecast[6] and builds on the Commission's opinions on the draft 2016 budgetary plans for euro area Member States, issued in November 2015, as well as on the guidance[7] that the Commission adopted last year on how to ensure that the common fiscal framework is supportive of the EU's jobs and growth agenda.

The country reports analyse in greater detail the barriers to investment identified by the Commission last year and presented together with the Annual Growth Survey 2016. It is necessary for Member States to work closely with each other and with the EU institutions to address these barriers in the context of the European Semester and to deliver on the third pillar of the Investment Plan for Europe[8].

The country reports serve as a starting point for dialogue with the Member States on the economic and social challenges they face. These dialogues together with the euro area recommendation should feed into the preparation of the National Reform Programmes to be presented in April. In principle, the Commission will not issue recommendations on issues that are not identified as challenges in the country reports, and will propose a limited number of country-specific recommendations for each Member State. These will differentiate as appropriate on the basis of the severity of the challenges, as also reflected in the country-specific situation under the macroeconomic imbalances procedure.

2. ECONOMIC CONTEXT

The European economy is pursuing its moderate recovery while external risks have increased. With GDP growth in 2015 at about only 3%, the world economy has been slowing down and its recovery path is surrounded by numerous risks.[9] While the largest advanced economies are experiencing continuing recoveries or maturing cycles, many emerging market economies are facing a difficult outlook. Growth in China is expected to slow down further, affecting mostly other emerging and developing economies and having an impact on global capital flows.

The European economy has so far managed to weather the risks, but the impact of a less benign external environment is increasingly being felt. The renewed drop in energy prices should continue to support households' purchasing power. The arrival of unprecedented

[5] COM (2015) 572, State of the Energy Union 2015; COM (2015) 576, Climate action progress report.
[6] European Commission, European Economic Forecast, Winter 2016.
[7] COM (2015) 12.
[8] COM (2014) 903.
[9] European Commission, European Economic Forecast, Winter 2016.

numbers of refugees and migrants has led to additional public expenditure due to increased reception and other refugee-related measures. Monetary conditions are set to remain highly accommodative and fiscal policy is expected to support the recovery this year. However, negative spillovers from slow growth outside the EU could be larger than the direct trade effect. Low commodities prices could also be a risk if they lead to instability in the world economy. Financial market volatility has markedly increased recently. In particular, bank stocks have been experiencing pronounced price falls and sovereign risk premiums have widened for some Member States.

The recovery in the EU remains slow and fragile, highlighting the need to step up structural reforms, encourage investment and build a more competitive economy. The recovery is weak both in historical perspective and compared to other advanced economies. EU economic growth is forecast to be 1.9% of GDP this year and to rise to 2% in 2017. Unemployment rates are set to continue falling from 9.5% in 2015 to 9% in 2016 in the EU, and the decline should be more pronounced in Member States where labour market reforms have been implemented. Private consumption is expected to remain the main driver of growth, supported by improving labour markets and increasing real disposable incomes. As the weakening of world demand reduces the prospects for an export-led recovery, a rebound in investment from the current low levels will be essential to sustain a more broad-based economic recovery and reverse the downward trend in potential growth.

3. PROGRESS WITH COUNTRY-SPECIFIC RECOMMENDATIONS

In the context of overall macroeconomic stabilisation, the Member States made some progress in addressing the issues identified in the country-specific recommendations issued in 2015. The 2016 country reports reveal that year-on-year progress stayed at a similar level. Looked at in a longer time frame, it is clear that the implementation of key reforms takes time to materialise. This can be due to both the complexity of the reforms to be undertaken, such as the reform of labour and product markets, pensions systems and banking sectors, and national election calendars. In a number of Member States (Denmark, Estonia, Ireland, Spain, Croatia, Poland, Portugal and Slovakia), national parliamentary or presidential elections took place in 2015 or early 2016. Both the number and the scope of the country-specific recommendations issued in 2014 and 2015 changed as well. The Commission will present its full assessment when proposing new country-specific recommendations in May.

Overall, Europe is on its way to meet part of the Europe 2020 strategy targets. Member States are well on their way to reaching the climate change and energy targets, as most are likely to reach their targets on emissions reduction, renewable energy and energy efficiency by 2020. According to the most recent available data, the EU is also on the right track on the education targets as 17 Member States have already reached their targets on early school leaving and 12 have reached their targets on tertiary education attainment. While the employment target will still prove difficult to reach for many Member States, the employment situation has improved in almost all Member States. Towards the end of 2015, employment was up by 1.1% reaching the pre-crisis level rate of 70.5%. The employment rate is growing faster for women, although the gender gap is still significant. Further efforts are needed to narrow the gap in the employment rate between men and women. Research and development expenditure as a percentage of GDP also increased in about half of the Member States but the EU target still seems difficult to reach. Particular problems persist in reaching the poverty target as the number of people at risk of poverty or social exclusion in Europe has increased due to the economic crisis. However, the most recent trends are more positive as the number of people at risk of poverty or social exclusion seems to have decreased in more than half of the Member States. This trend is expected to have continued in 2015 in line with the improved employment conditions. Appendix 2 provides an overview of all Europe 2020 strategy targets.

4. ADDRESSING MACROECONOMIC IMBALANCES

The EU and the euro area Member States are making progress with rebalancing their economies. Some of the imbalances are the legacy of the crisis, but many were in place before it started and contributed to the deep impact of the crisis. Putting the EU economies on the path of sustainable rebalancing is important not only for individual Member States, but also for the EU and the euro area as a whole, with a view to achieving a better resistance to future shocks and move towards more sustainable, cohesive and higher growth.

The in-depth reviews provide a comprehensive analysis of the imbalances experienced by the Member States. The in-depth reviews differentiate between the adjustments driven by cyclical factors and those resulting from structural reforms and confirm that only the latter provide a foundation for sustainable growth. Given the importance of trade and financial links between EU countries, the analysis also looks into the cross-border implications of rebalancing, pointing to the need for it to take place both in countries with large stocks of external liabilities and in those with surpluses. It remains urgent to reduce debt levels. While, in some cases, the reduction of public or private debt is progressing, their elevated levels can make economies still vulnerable to potential shocks. In other cases, low but rising debt levels can signal growing vulnerabilities.

4.1. Rebalancing in the EU and the euro area

The adjustment of the existing imbalances is hindered by several factors. Subdued nominal growth and very low levels of inflation hamper the deleveraging process. The weakening of world demand reduces the prospects for an export-led recovery. Persisting high unemployment in some Member States may reduce potential output growth, also because of loss of skills and employability.

The correction of external imbalances is progressing. In countries with high external liabilities, the large current account deficits of the pre-crisis period have been considerably reduced or have moved to surplus. Helped by external factors, cost competitiveness has generally improved. In some Member States, there is evidence of structural adjustment in terms of resources shifting to the tradable sector. The current account of the euro area is currently posting one of the world's largest surpluses. The surplus of a few Member States stands out in terms of size and indicates that both internal demand and investment are subdued.

Vulnerabilities associated with elevated levels of debt remain a source of concern. In most countries, the process of balance sheet repair is progressing, with deleveraging ongoing in the household and corporate sectors. However, this deleveraging is often linked to reduced spending. In some countries, the level of private debt relative to GDP has gone down due to robust growth recovery. The stock of liabilities remains at an historically high level in a number of Member States. In countries where deleveraging pressures weigh on the recovery and reduce prospects for investment and consumption, there is an additional need to focus on creating conditions for improving productivity and competitiveness to contain the impact of deleveraging on growth and employment.

The banking sector has increased its capitalisation, but pressures remain, linked to deteriorated credit and asset quality and low profitability. Banks have made substantial progress in adjusting their balance sheets and banking institutions are generally well capitalised and liquid. At the same time, due to a combination of several factors, the banking sector in some countries is still recording a high share of non-performing loans and bad asset quality. If unaddressed, these weaknesses may result in subdued credit growth and suboptimal credit allocation. Moreover, the low growth and low interest rate environment has an impact on profits in the banking sector.

Structural reforms are needed to facilitate the reallocation of resources across firms, sectors and regions, to increase productivity, competitiveness and sustainable employment. Member States need to improve the reallocation of available resources, by shifting them to the tradable sectors and the most productive firms operating within each sector of the economy. This can be helped by reforms opening the product and services markets, which would also boost the EU internal market, and by structural reforms to eliminate barriers to the free circulation of goods and services.

4.2. Implementing the macroeconomic imbalances procedure

The Commission has improved the transparency of the macroeconomic imbalances procedure. The assessments in the country reports reflect the commitments contained in the Commission Communication on steps towards completing Economic and Monetary Union[10], notably enhanced transparency in the implementation of the procedure. The findings of the in-depth reviews have been more effectively presented in the country reports by means of summary tables, describing the sources of imbalances and illustrating the main findings regarding the development of relevant economic variables, the policy response and the outstanding policy gaps. The Commission services will also issue a compendium that will bring together in a single document relevant information on the macroeconomic imbalances procedure.

The Commission is streamlining and stabilising the categories of macroeconomic imbalances. To ensure more effective and simpler communication, the macroeconomic imbalances categories have this year been streamlined from the existing six to four: no imbalance, imbalances, excessive imbalances, and excessive imbalances with corrective action. These categories will be kept stable in the coming years. Specific monitoring will be activated in case of imbalances or excessive imbalances and modulated according to the gravity of underlying challenges. The country-specific recommendations will be tailored to reflect the nature of imbalances, in the light of reform measures proposed by the Member States in the National Reform Programmes.

Table 1: Categorisation of imbalances in the macroeconomic imbalances procedure

[10] COM (2015) 600.

Previous categories	Streamlined categories
No imbalances	No imbalances
Imbalances, which require policy action and monitoring	Imbalances
Imbalances, which require decisive policy action and monitoring	
Imbalances, which require decisive policy action and specific monitoring	
Excessive imbalances, which require decisive policy action and specific monitoring	Excessive imbalances
Excessive imbalances with corrective action*	Excessive imbalances with corrective action

*The 'excessive imbalances with corrective action' category implies the opening of the excessive imbalance procedure under Regulation (EU) No 1176/2011.

Spillovers to other countries and systemic issues have also been taken into account in the in-depth reviews. The identification and assessment of macroeconomic imbalances takes into account the fact that a coordinated approach at the euro area level is warranted to address imbalances, while supporting the recovery. The macroeconomic imbalances procedure aims at preventing and correcting imbalances that could be harmful for the country itself, the euro area or the EU. In its Alert Mechanism Report 2016[11] published alongside the Annual Growth Survey 2016, the Commission considered that 18 Member States should be subject to an in-depth review to assess in greater detail the severity of possible imbalances.

Fewer Member States than last year are considered to have imbalances. Of the 18 Member States retained for further analysis, the in-depth reviews have found that six Member States are experiencing no imbalances, seven Member States are experiencing imbalances and five Member States are experiencing excessive imbalances. For Croatia and Portugal, the Commission will review its assessment in May, taking into account the level of ambition of their National Reform Programmes (NRPs). Appendix 3 summarises the findings from the in-depth reviews by Member State.

Table 2: Outcome of the 2016 in-depth reviews (streamlined categories)

No imbalances	BE, EE, HU, AT, RO, UK
Imbalances*	DE, IE, ES, NL, SI, FI, SE
Excessive imbalances*	BG, FR, HR, IT, PT

*Both the 'imbalances' and 'excessive imbalances' categories entail specific monitoring, to be modulated depending on the severity of the challenges.

[11] COM (2015) 691.

Under the streamlined categories of the macroeconomic imbalances procedure, surveillance will include specific monitoring for all Member States concerned by imbalances and excessive imbalances. Specific monitoring should ensure the enhanced surveillance of the policy response to the imbalances identified, through an intensified dialogue with the national authorities, expert missions and regular progress reports to be discussed with all Member States. Such contacts will also help the monitoring of the implementation of the country-specific recommendations in the Member States concerned. The monitoring may vary depending on the exact nature of the imbalance. As a rule, countries experiencing excessive imbalances will be subject to tighter monitoring. Countries in the category 'excessive imbalances with corrective action' will be subject to the excessive imbalance procedure (EIP), which entails policy recommendations to remedy the imbalances and follow-up through a corrective action plan.

5. Reforms by the Member States

There is progress in the reforms in most of the Member States. These reform efforts need to be sustained and reinforced in order to prepare economies for future shocks and build up competitiveness. The strength and sustainability of the recovery depends on the speed and effectiveness of the adoption and implementation of the reforms. EU funds, in particular the European Structural and Investment Funds, can and should be used to facilitate reforms. While last year's country-specific recommendations identified issues that were at the heart of economic and social policy discussions in the Member States, in several cases the country reports point to new developments, such as the influx of migrants and refugees.

Qualitative aspects of the reforms are important for success. An efficient allocation of resources towards more productive firms would increase productivity and growth rates. Furthermore, it would increase investment by more efficient firms, strengthening the long-term growth potential of Member States’ economies. Reforms in product, services and labour markets take time to deliver results but they trigger this reallocation of resources, activating investment and modernising the productive base of the EU economy.

The reforms at Member State level are needed to complement those undertaken at EU level. There have been a number of policy reforms and tools agreed at the EU level, which aim at providing a better business environment and a more certain and stable regulatory environment, such as the single market strategy, the digital single market, the energy union, the capital markets union, the circular economy package and the better regulation agenda. The section below describes progress by Member States in advancing reforms in the areas identified in last year's country-specific recommendations.

5.1 Re-launching investment

Improving investment conditions requires action on several fronts. There is a need to attract more private financing for investments in the real economy and to ensure good quality public investment. In line with the Investment Plan for Europe, for investment to start contributing to growth and employment creation more strongly, it is necessary to improve risk financing, to create a better environment for investment and to develop better structured and more visible investment projects. The Commission already implemented a number of reforms at European level to spur investment such as the proposal under Solvency II. Commission services also provided a detailed identification of the main investment challenges in each Member State[12]. These include regulatory and administrative barriers, public procurement, taxation, judicial systems, access to finance and insolvency frameworks, education and skills, and sectoral regulations. In addition, the Commission identified the need to have access to increased and more diversified sources of funding and the need to extend priorities beyond traditional infrastructure to include human capital and related social investment.

Investment has so far failed to emerge as a strong driver of the recovery.[13] Member States are encouraged to ensure an environment that is conducive to investment – by removing bottlenecks, providing greater regulatory predictability, reinforcing the single market, identifying a stable pipeline of projects and ensuring coordination and planning by all levels of the administration. For most Member States, the negative impact of the financial crisis on investment is still being felt while some have experienced shifts in the relative balance between public investment and private or business investment. Ireland is an example of a Member State where, after a major and difficult adjustment process, strong private investment is playing a central role in the economic recovery.

EU funds have continued to play a key role in a number of Member States. In Bulgaria, the Czech Republic, Estonia, Croatia, Latvia, Lithuania, Hungary, Malta, Poland, Portugal, Romania, Slovenia and Slovakia, EU funds account for a large share of investment. The Commission is working closely with the Member States to improve how the funds are managed and invested. Absorption rates can be increased through strengthened administrative capacity of national and regional administrations and technical assistance, contributing also to an optimal combination of the different EU funds.

In the 2014-2020 multiannual financial framework, the European Structural and Investment Funds are closely linked to the objectives of the Europe 2020 strategy and to the macroeconomic challenges identified in the country-specific recommendations. Beyond absorption levels, it is important to make sure that EU funds are put to the most effective use in terms of addressing the economic and social challenges in Member States. The delayed programming of some of the funds calls for extra efforts now to ensure a

[12] SWD (2015) 400.
[13] European Commission, European Economic Forecast, Winter 2016.

speedier and smooth disbursement. Some Member States still need to fulfil ex-ante conditionalities, otherwise the Commission may suspend interim payments to the priorities of the programmes concerned. Financing under the European Fund for Strategic Investments, Horizon 2020, the Connecting Europe Facility (including over EUR 4.1 billion for the transport sector alone) and other directly managed EU funds is additional to the European Structural and Investment Funds, and these opportunities should optimally be combined. Under the European Structural and Investment Funds, more than EUR 450 billion are made available to Member States between 2014 and 2020 to finance smart and inclusive growth, competitiveness and cohesion.

Despite some progress, barriers to investment persist in some key sectors in many Member States. This is particularly the case for services, network industries and construction. The relatively favourable business environment in Member States such as Estonia and the United Kingdom acts as an incentive to investment. However, a number of Member States are characterised by barriers to investment in the form of administrative burden, bureaucracy, inefficient public administration, legal uncertainty or changing legislative environments, and a lack of transparency, which hampers the fight against corruption. Cumbersome or lengthy procedures in large scale projects have been identified in several Member States. These can create entry or establishment barriers, for example in the retail sector and professional services. Difficult access to finance also acts as a brake on investment in some Member States.

Restoring lending to the real economy

The financial sector has continued to ease credit conditions. Despite reduced credit growth in countries where deleveraging is ongoing, positive developments are taking place in credit supply. According to the January 2016 European Central Bank lending survey[14], banks reported a continued net easing of credit standards on loans to enterprises and to households for house purchase, and on consumer credit. Competition remained the main factor driving the easing in banks' credit standards on loans to enterprises. Banks continued to ease terms and conditions for new loans across all loan categories, particularly for enterprises. The progress being made in strengthening banks is also supportive of easier credit conditions.

There has been some progress in improving access to finance. Several Members States have put in place or stepped up initiatives to improve access to finance. Hungary launched the Funding for Growth Scheme. Several initiatives to improve access to finance for small and medium-sized enterprises, in particular by tapping EU funds, are also underway. For example, Portugal has made available resources for investments in equity and venture capital through European structural funds and national funds. Malta is combining local and EU funds to provide SMEs with tax credits, grants or financial guarantees.

Insolvency frameworks have been improved in a number of Member States. Croatia has revised the corporate and personal insolvency legislation. Ireland introduced changes to the insolvency framework aiming at increasing the use of personal insolvency and bankruptcy

[14] European Central Bank, The euro area bank lending survey, Fourth quarter of 2015, January 2016.

schemes. Spain introduced a new personal insolvency framework and made corporate insolvency procedures and out-of-court procedures more flexible.

5.2 Pursuing structural reforms to modernise economies

In the 2016 Annual Growth Survey, the Commission placed emphasis on effective coordination between Member States, aiming at higher productivity and upward convergence; the need to balance flexibility and security in labour market policies; and the need for more integrated and competitive product and services markets.

Employment and social policy

Employment is now growing in both the EU and the euro area. Unemployment, including youth unemployment, is decreasing. At the same time, long-term unemployment was still growing in 2015 compared to 2014 even though, in the course of the year, a gradual reduction has been observed. Long-term unemployment concerns 10.5 million people and accounts for 48% of total unemployment. Youth unemployment stands at 20%, meaning that four and a half million young people are unemployed. In some Member States, many young people are leaving the country. In Greece, Spain, Croatia and Italy, youth unemployment amounts to around 40% or more. In addition, a number of Member States have high levels of young people who are not in employment, education or training, reaching more than 20% in Bulgaria and Italy.

In order to strengthen the EU's competitiveness position, it remains important that, over the medium term, real wages continue to move in line with productivity. A number of countries have made efforts to enhance the responsiveness of their labour markets and to facilitate the growth of firms. This included the removal of some thresholds rules for firms and the improvement of the predictability of the outcomes of labour disputes, which can facilitate initial hiring by firms. While there has been overall an alignment of wage developments with productivity levels in the EU, in a few Member States progress in this area has been limited. In line with 2015 country-specific recommendations, inter-sectorial wage moderation agreements were concluded in Finland for 2014-2015 and in Spain for 2015-2017. New mechanisms to set the minimum wage were introduced in Ireland and a national mandatory minimum wage was introduced in Germany.

Further efforts are needed to tackle the segmentation of labour markets. Reducing the regulatory gap between open-ended and non-standard contracts can foster transitions towards open-ended contracts and promote the creation of stable employment, incentivising employers and employees to invest in skills and lifelong learning. Reforms along these lines continued in 2015, in line with country-specific recommendations, especially in countries experiencing considerable labour market duality such as Italy and Poland. As part of a comprehensive labour market reform, Italy has simplified contractual arrangements and labour law procedures and has reduced the scope for reinstatement following unfair dismissals.

The Youth Guarantee, now in its third year of implementation, is delivering results. The situation of young people in the EU is improving, and efforts towards better school-to-work transitions have been stepped up, including by early activation and outreach to those not in employment, education or training. Improved outreach, better tailored public employment services' support to young people, improved design of active labour market instruments for young people and a stronger focus on quality apprenticeships are among the main results. Reforms in the context of the Youth Guarantee accelerated, particularly in Member States facing significant challenges, such as Italy and Portugal, and in Member States receiving EU financial support with which innovative, large scale measures and structural reforms could be tackled.

While progress has been made in bringing back to the labour market the unemployed, further reform of active labour market policies is needed. A number of Member States such as Spain, France, Latvia and Finland have launched new active measures targeting the long-term unemployed. Italy is starting to reform the governance of active labour market policies and strengthen the links with passive policies. However, some other challenges remain to be addressed, such as insufficient coordination between employment and social services, lack of involvement and partnerships with employers, comparatively low participation rates in active labour market policy measures and their insufficient funding. In addition, some countries do not provide individualised approaches based on profiling, skills matching or intensive counselling. The Recommendation on the integration of the long-term unemployed into the labour market adopted by the Council in December 2015[15] offers the Member States the guidance on how to step up efforts to tackle long-term unemployment.

Poverty requires a comprehensive policy response. Steps have been or are being taken in a number of Member States with regard to social assistance and, in particular, adequacy and/or coverage of minimum income. Given that income support should be combined with good labour market matching, various financial and non-financial incentives are also being introduced to facilitate a return to the labour market. These include the design of unemployment benefit systems in Denmark and Italy and in-work benefits in Malta. In order to strike a balance between the objectives of reducing poverty and increasing labour market participation, some Member States, such as the United Kingdom, are trying to streamline various benefits into broader schemes. Concerns about the effects of increasing numbers of children affected by poverty have seen some Member States step up the corresponding social benefits. There has been limited progress on the inclusion of Roma in the relevant Member States.

The successful integration of migrants and refugees in some Member States requires particular attention. The high inflow of migrants and refugees over the last year is a major challenge for many Member States and the EU. However, it is also an opportunity, especially for Member States undergoing demographic changes. Experience with earlier flows of refugees suggests that they may face greater difficulties to integrate into the labour market

[15] Council document 14361/15.

than average third-country nationals. Successful integration requires, among other things, an early assessment of skills, a quick recognition of qualifications and appropriate language training in order to provide early and effective access to the labour market, healthcare and housing. Given the high share of children and young people (about 26%), education systems in particular need to adapt quickly and offer tailored programmes for basic and linguistic skills. Moreover, the successful integration of women deserves particular attention.

The performance of education and training systems remains a concern in many Member States. Although the share of early school-leavers has come down on average to 11.1%, nine Member States are still above the Europe 2020 strategy headline target of 10%. These structural weaknesses put Europe's growth potential at risk. Many Member States are developing skills strategies and implementing structural reform of their education systems. The Czech Republic has adopted a higher education reform and Bulgaria has adopted the Pre-school and School Education Act, which provides a consolidated legal framework for improving the quality and equity of education at primary and secondary levels. Italy has introduced a school reform increasing school autonomy, introducing merit-based components for teachers' salaries and improving the system of teacher recruitment.

The tax burden on labour should be further lowered. Many Member States have taken measures to reduce labour taxation. For example, Estonia and France took steps to reduce labour taxation on low income earners. Moreover, labour taxation reforms have been implemented in some Member States characterised by high unemployment rates, such as Belgium, Spain and Italy. However, the tax wedge on labour, in particular on low incomes, remains high in several Member States and has even increased in some countries.

Business environment and network industries

A more business and employment friendly regulatory environment will encourage private investment. Improving public administration practices, eliminating corruption, introducing transparency, light and predictable regulations contribute to increasing competitiveness, growth and job creation. Progress can be reported in this sense. Italy took steps to reform further and accelerate insolvency foreclosure procedures. France has continued pursuing an ambitious simplification agenda comprising by now more than 600 measures, of which about one third have been implemented so far. Croatia made some progress in improving the pre-insolvency and insolvency framework for corporate entities. Malta has introduced a number of new technological and procedural systems to reduce bureaucracy and delays in civil courts. In Latvia, there has been substantial progress on mediation and arbitration frameworks. The quality, independence and efficiency of justice systems remain a challenge in certain Member States, even if justice reforms made some progress in Italy, Latvia and Slovenia.

There is further scope for cutting red tape, strengthening both administrative efficiency and regulatory quality. Delays in licensing procedures remain significant and over two thirds of Member States still charge start-ups over the limit of EUR 100 suggested in the Small Business Act. Structural reforms are often delayed by the lack of implementation capacity and unstable institutional structures. The efficiency of public investment is often hampered by shortages related to project appraisal, procurement, implementation and weak coordination between different levels of government. The provision of advanced and well-integrated e-government services for businesses remains a challenge in many Member States.

Public procurement remains an area requiring further improvement. For some Member States, shortcomings in public procurement remain one of the main sources of irregularities detected in audits of the use of the European Structural and Investment Funds. These act as a deterrent to investment and the correct functioning of the single market. Public procurement is also an area where there are corruption concerns.

Investments in the energy and transport networks contribute to integrated and better functioning markets, improved security of supply, and are essential for the transition to a low-carbon economy. The completion of electricity and gas interconnectors between Spain and France will, for example, be crucial for ensuring the security of supply and improving the functioning of energy markets. The investments in electricity transmission capacity as well as gas interconnections with and between the Baltic states are also progressing with the aim of integrating these Member States into the European networks and energy markets. The recent completion of the electricity connections between the three Baltic states and Poland, Finland and Sweden brings the interconnection ratio to around 25%, with further investments in interconnections between the Baltic states on-going. Spain has established a fund to improve land access to maritime ports.

The modernisation of the EU economy requires the elimination of the infrastructure deficits in digital communication networks. The expected increase in the demand of high quality communication networks should not be delayed by late supply-side reactions. In some Member States, despite significant efforts to improve the coverage of new generation communications infrastructure networks, it will be difficult to meet the Digital Agenda target on the coverage of next generation networks of 30 Mbps or more for all by 2020.

Reforms in product and services markets

The number of restrictions in services sectors remains high in many EU Member States. As reflected in the latest Commission estimates accompanying the publication of the Single Market Strategy[16], regulatory restrictions have a proven detrimental impact on investment, growth and employment.

The track record of the European Semester in this area proves that reforms pay off. The OECD[17] has estimated that structural reforms introduced in Italy in 2012 should increase GDP by 1.5 percentage points five years after their introduction. Many of these reforms responded to recommendations issued to Italy in the context of the Semester. Other reforms have delivered visible results faster. In response to a recommendation issued to Spain in 2012, the introduction of express licences for the opening of commercial establishments led to an extra 7,000 establishments being opened in the first half of 2013.

Country reports show positive but still slow progress in reforming services markets in many Member States. The contribution of the business services sector to the productivity of manufacturing and other services sectors is essential for the modernisation of EU economies. The level and number of restrictions prevailing in the markets of professional business services, especially in engineering, accounting, architecture and legal services, warrant special attention.

[16] COM (2015) 550.
[17] OECD, Italy. Structural Reforms: Impact on Growth and Employment. February 2015.

Reforms in professional services can bring tangible results but progress is particularly slow. Following a 2011 recommendation, Slovenia adopted in 2012 a programme aimed at deregulating professions. Further recommendations were issued in subsequent years, leading to the full deregulation or the simplification of the access to professions in several sectors (construction, retail, tourism) at present. Poland started in 2012 a gradual and extensive process of reforms of regulated professions. The reform covered 248 professions and, for most of them, the existing barriers have been partially abolished, while for 70 of them restrictions have been completely abolished. Poland adopted the third and last tranche of this deregulation reform in 2015. Following a 2014 country-specific recommendation on legal services, Ireland had made significant progress by the end of 2015, adopting legislation for the opening of those markets.

The construction sector can provide an important contribution to consolidating the recovery but reforms are needed. The recovery of the sector after the crisis is proving to be slow and difficult and reforms would contribute to reactivating it, although the unsustainable pre-crisis levels should not be taken as a reference. In 2015, the Commission carried out an in-depth review of barriers in the construction sector, which confirmed a wide diversity of treatment across Member States.

Country-specific recommendations on the construction sector were issued to eliminate regulatory restrictions in Denmark, Germany, Lithuania, Poland, Slovakia and Sweden in recent years. So far, progress is limited. As of June 2015, a new Construction Law simplified the administrative obligations regarding construction in Poland. However, it addressed only a limited number of issues. In Sweden, a commission of inquiry has been assigned to investigate and come up with proposals on how to improve competition in the housing construction and building materials sectors. In Slovakia, an amendment to the Construction Act was adopted in September 2015 to streamline the administrative procedures for obtaining land-use and construction permits.

Stepping up reforms to reduce regulatory barriers in the retail sector would have a considerably positive impact. Increased competitive pressures following a reduction in barriers would improve market structure and investment dynamics, leading to the entry of more efficient and innovative firms. Consumers would benefit from lower prices, more variety, innovation and higher quality, thereby stimulating consumption.

Overall, Member States have made some progress in improving the regulatory environment in the retail sector, but still more effort is needed. In particular, there is scope to improve establishment conditions. Finland has abolished the law regulating opening hours and some steps have also been taken to improve establishment conditions in the retail sector through amendments to land use planning. In Spain, the 2014 reform in the retail sector set the grounds for improved establishment and operational conditions. However, the benefits of this reform can only be reaped in practice when the autonomous communities adopt the necessary implementing acts.

Country reports also highlight the need for further reforms aimed at reducing barriers in product markets. Italy has undertaken reforms in recent years to reduce market restrictions and increase competition through a liberalisation package in 2012 and a more recent privatisation plan and competition law. It is expected that increased competition in energy and telecommunications sectors and the privatisation plan could boost GDP by almost 0.2% in 2020. Some Member States still show a comparatively high level of regulatory burden for product markets in sectors such as electricity, gas, telecommunications, post, rail and road transport.

Reforms by Member State to improve efficiency in the use of resources and to bring forward a much more circular economy will contribute towards stimulating investments. Several Member States are taking steps in this direction. Circular economy programmes have been put in place in Belgium and the Netherlands. Portugal adopted a Commitment for Green Growth, setting out an extensive range of measures promoting the transition to a more resource efficient, green and low-carbon economy.

Innovation

Innovation is a driver for modernising the economy, attracts investment and supports economic growth. Creating conditions for innovation requires a combination of financial incentives and a stronger link between business and academia. In order to stimulate research, development and innovation, an increasing number of Member States emphasise indirect support measures, such as tax incentives. For example, Poland introduced new research and development tax incentives at the beginning of 2016. There are also new tax exemptions for funds on the sale of stocks of qualifying companies, which is expected to provide a stimulus to equity financing for innovative businesses. Estonia launched initiatives to promote innovation in public procurement and provided funding for several technology centres and an innovation voucher system, enabling small and medium-sized enterprises to cooperate with universities and competence centres. However, the link between academia, research and business innovation needs to be strengthened in many Member States, particularly in those where overall innovation performance recently stagnated or even decreased, and in others where a significant gap to the performance of the innovation leaders still remains, despite some recent progress.

5.3 Responsible fiscal policies

Although headline budget deficits have been substantially reduced in recent years and are projected to continue decreasing, several Member States are falling short of the requirements under the Stability and Growth Pact. The debt-to-GDP ratio is forecast to decrease gradually from the peak reached in 2014. The deficit reduction over the period 2015 to 2017 is mostly driven by the economic recovery and lower interest expenditure, while other items of revenue and expenditure are overall expansionary. As a result, the structural deficit is expected to increase slightly in the euro area and to stabilise in the EU after years of continuous improvement. Fiscal policies should be assessed against the twin objectives of long-term sustainability of public finances and the need to support the moderate recovery.

Growth could be supported by making the composition of revenue and expenditure more growth-friendly. More progress needs to be made on reducing the tax burden on labour. Building on the progress made on fighting tax evasion and improving tax administration, further efforts are needed to make tax systems fairer and more effective, to address disincentives to employment creation, to prioritise growth-friendly expenditure and to preserve productive public investment. In this regard, the projected further reduction in the ratio of public investment to GDP over the period 2015 to 2017 shows that more effort is needed.

Box 1. Update on surveillance under the Stability and Growth Pact

In its assessment of the 2016 draft budgetary plans for euro area Member States, published in November 2015, the Commission indicated that for four countries (Spain, Italy, Lithuania and Austria[18]), these plans posed a risk of non-compliance with the provisions of the Stability and Growth Pact. Seven countries (Belgium, Ireland, France, Latvia, Malta, Slovenia and Finland) were found to be broadly compliant, while Germany, Estonia, Luxembourg, the Netherlands and Slovakia were compliant with the requirements for 2016. Portugal did not submit its draft budgetary plan by the deadline but only on 22 January 2016, due to national elections in October 2015 and the time needed to form a new government.

Following the finalisation of the 2016 budgets for most Member States, the Commission's 2016 winter forecast provides a basis for assessing how Member States have taken into account the Commission opinions on their draft budgetary plans and have acted upon their commitments made in the Eurogroup.

- Spain is projected to have missed its headline deficit target for 2015 and is projected to miss a timely and durable correction by 2016, while the recommended fiscal effort is not being delivered.
- Regarding Belgium, Finland and Italy, the Commission continues its close monitoring of compliance with the debt criterion and stresses the importance of continued strong implementation of compliance with the recommended structural adjustments under the Pact. The Commission will reassess the situation in May on the basis of the outturn data for 2015, the forthcoming Stability Programmes and the Commission's 2016 spring forecast.
- Portugal submitted its Draft Budgetary Plan on 22 January 2016. In its opinion on the Draft Budgetary Plan, the Commission considered that the government's plans are at risk of non-compliance with the provisions of the Stability and Growth Pact and invited the authorities to take the necessary measures within the national budgetary process to ensure that the 2016 budget will be compliant with the Stability and Growth Pact. The Commission will reassess the situation in May on the basis of Portugal's nation al reform programme.

The Commission will monitor the budgetary developments of all Member States in the context of the European Semester, based on the National Reform Programmes and Stability or Convergence Programmes to be submitted by mid-April, and will provide its recommendations in May, together with other procedural steps under the Pact as needed.

The country reports include also an assessment of the Member States' response to recommendations calling for strengthening the institutional and longer term dimension of their fiscal policy.

Fiscal institutions and governance, and long term sustainability of public finances

Many Member States took steps to reinforce various aspects of their fiscal frameworks. Progress is being made towards stronger national fiscal frameworks, which are key to achieving and maintaining appropriate fiscal policies. Bulgaria adopted legislation specifying the conditions to guide the correction of slippages, Croatia has made some efforts to improve the accuracy of budgetary planning and to tighten expenditure control, Portugal further reformed the Budget Framework Law and Slovenia adopted implementing legislation for the constitutional budget balance rule. Furthermore, independent fiscal institutions monitoring the application of national fiscal rules and fiscal plans have been established or reinforced in most Member States. To date, the Czech Republic and Poland remain the only Member States that have not legislated for the establishment of fiscal councils.

[18] In the case of Austria, the draft budgetary plan was found to be broadly compliant after correcting for the planned additional costs related to the exceptional inflow of refugees and migrants.

The Commission is reviewing the transposition of the rules set out in the so-called Fiscal Compact,[19] which are designed to strengthen the consistency between the national and European fiscal frameworks and enhance their ownership in Member States. The Commission is engaging in consultations with Contracting Parties, with a view to giving them the opportunity to submit their observations on the Commission's findings, as foreseen in Article 8(1) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, prior to the adoption of its report in 2016.

The projected increase in age-related expenditure could pose risks for the sustainability of public finances in the medium to long run. The population is rapidly ageing in the EU and in the euro area in particular. The working age population is expected to decline at an annual average rate of 0.4% over the coming four decades. Ageing has a direct impact on public finances through spending on pensions, health care and long term care. Unless corrective measures are taken, more than half of the Member States face either medium or high sustainability challenges.[20] Good progress has been made in many countries and long term sustainability challenges have decreased since the beginning of the crisis, notably due to implemented pension reforms and recent fiscal consolidation. However, there remain significant challenges to be faced in terms of projected developments of age-related spending.

Progress in reforming pension systems varies among the Member States. The pension system was identified as a longer term challenge in a number of Member States (Belgium, Bulgaria, Croatia, Lithuania, Luxembourg, Malta, Austria, Poland, Portugal, Romania and Slovenia) in last year's country-specific recommendations. Belgium adopted the last part of the pension reform that was agreed in 2014, notably an increase in the statutory retirement age to 66 years in 2025 and 67 in 2030. In Finland, the Parliament adopted a pension reform in November 2015. In particular, the earliest eligibility age for old age pension will be gradually raised to 65 by 2025. As of 2027, the earliest eligibility for old age pension will be linked to life expectancy so that the time spent working in relation to the time spent in retirement will remain at the 2025 level. In France, the agreement in October 2015 between social partners is expected to improve the financial situation of the complementary pension scheme.

For a number of Member States, the country-specific recommendations identified healthcare systems as requiring particular attention. Progress in reforming health care systems, with the aim of ensuing efficiency and affordable access to services, varies among the Member States. Ireland, Spain and Romania have taken action to control expenditure on medicines. Romania has made progress in remedying the inefficient use of resources and Ireland has made progress on implementing activity-based funding. Slovakia has strengthened the gatekeeping role of general practitioners, its financial audits and information system. The Czech Republic is improving hospital efficiency, the contractual transparency between insurers and providers and the centralisation of public procurement procedures. The reforms initiated in a number of Member States need to continue and be deepened so as to ensure a sustainable financing basis for health systems as well as adequate access for all to effective health care.

6. NEXT STEPS

[19] i.e., the fiscal part of the Treaty on Stability Coordination and Governance in the EMU.
[20] For an assessment of fiscal sustainability challenges, see European Commission (2016), 'Fiscal Sustainability Report 2015', European Economy, Institutional papers, No 18.

Following the discussions in the Council and broader dialogue with the European Parliament, social partners and stakeholders, the recommendations for the economic policy of the euro area have been endorsed by the European Council at its meeting of 18-19 February 2016.

The analysis presented in the country reports will be discussed with the Member States in bilateral meetings. Commission Vice-Presidents and Commissioners will visit Member States to meet the governments, national Parliaments, social partners and other stakeholders.

The identified challenges are expected to be addressed by the Member States in their National Reform Programmes, as well as Stability or Convergence Programmes, to be published and presented to the Commission by mid-April. The Commission has called on Member States to consult closely national Parliaments and social partners when preparing their national programmes.

APPENDIX 1 - INTEGRATED SURVEILLANCE OF MACROECONOMIC AND FISCAL IMBALANCES

	Outcome of the 2016 in-depth reviews under the Macroeconomic Imbalances Procedure (MIP)[21]	**Stability and Growth Pact** **(MTO: medium term objective / EDP: excessive deficit procedure)**[22]	**Comments, including changes as of 8 March 2016**
BE	No imbalances	Preventive arm Not yet at MTO; subject to transitional debt rule[23]	Exit from MIP
BG	Excessive imbalances	Preventive arm Not yet at MTO	
CZ		Preventive arm At MTO	
DK		Preventive arm Not yet at MTO	
DE	Imbalances	Preventive arm Overachieving MTO; subject to debt rule	
EE	No imbalances	Preventive arm Overachieving MTO	
IE	Imbalances	Corrective arm Excessive deficit, deadline for correction: 2015 Not yet at MTO; subject to transitional debt rule[24]	
EL		Corrective arm Excessive deficit, deadline for correction: 2016	Under a dedicated financial assistance programme
ES	Imbalances	Corrective arm Excessive deficit, deadline for correction: 2016	Autonomous fiscal recommendation in view of risks to the timely correction
FR	Excessive imbalances	Corrective arm Excessive deficit, deadline for correction: 2017	
HR	Excessive imbalances	Corrective arm	

[21] Both the 'imbalances' and 'excessive imbalances' categories entail specific monitoring, to be modulated depending on the severity of the challenges.

[22] Categorisation based on the estimated outturn for 2016 as reflected in the Commission 2016 winter forecast.

[23] Debt rule: If the 60% reference for the debt-to-GDP ratio is not respected, the Member State concerned will be put in excessive deficit procedure, after taking into account all relevant factors and the impact of the economic cycle, if the gap between its debt level and the 60% reference is not reduced by 1/20th annually (on average over 3 years). Transitional debt rule: Each Member State in excessive deficit procedure is granted a three-year period following the correction of the excessive deficit for meeting the debt rule. This does not mean that the debt rule does not apply at all during this period as Member States should make sufficient progress towards compliance during this transitional period. A negative assessment of the progress made towards compliance with the debt benchmark during the transition period could lead to the opening of an excessive deficit procedure.

[24] Conditional on the abrogation of the EDP decision based on outturn data for 2015.

		Excessive deficit, deadline for correction: 2016	
IT	Excessive imbalances	Preventive arm Not yet at MTO; subject to debt rule	
CY		Corrective arm Excessive deficit, deadline for correction: 2016	Under a dedicated financial assistance programme
LV		Preventive arm Not yet at MTO	
LT		Preventive arm Not yet at MTO	
LU		Preventive arm Overachieving MTO	
HU	No imbalances	Preventive arm Not yet at MTO; subject to debt rule	Exit from MIP
MT		Preventive arm Not yet at MTO; subject to debt rule	
NL	Imbalances	Preventive arm Not yet at MTO; subject to transitional debt rule	
AT	No imbalances	Preventive arm Not yet at MTO; subject to transitional debt rule	
PL		Preventive arm Not yet at MTO	
PT	Excessive imbalances	Corrective arm Excessive deficit, deadline for correction: 2015 Not yet at MTO; subject to transitional debt rule	
RO	No imbalances	Preventive arm Not yet at MTO	Exit from MIP
SI	Imbalances	Corrective arm Excessive deficit, deadline for correction: 2015 Not yet at MTO; subject to transitional debt rule	
SK		Preventive arm Not yet at MTO	
FI	Imbalances	Preventive arm Not yet at MTO; debt above 60% of GDP reference value	
SE	Imbalances	Preventive arm At MTO	
UK	No imbalances	Corrective arm Excessive deficit, deadline for	Exit from MIP

		correction: 2016-17	

(Situation as at 8 March 2016)

APPENDIX 2 - PROGRESS TOWARDS EUROPE 2020 STRATEGY TARGETS

Europe 2020 strategy targets for the EU	2010 data	Latest available data	In 2020, based on recent trends
1. Increasing the employment rate of the population aged 20-64 to at least 75%	68.6%	69.2% (2014) 70.5% (3Q 2015)	Target unlikely to be met
2. Increasing combined public and private investment in R&D to 3% of GDP	1.93%	2.03% (2014)	Target unlikely to be met
3a. Reducing greenhouse gas emissions by at least 20% compared to 1990 levels	14.3% reduction	23% reduction (2014)	Target likely to be met
3b. Increasing the share of renewable energy in final energy consumption to 20%	12.8%	16% (2014)	Target likely to be met
3c.Moving towards a 20 % increase in energy efficiency	5.6% increase (for primary energy consumption)	15.7% increase (2014)	Target likely to be met
4a. Reducing school drop-out rates to less than 10%	13.9%	11.2% (2014)	Target likely to be met
4b. Increasing the share of the population aged 30-34 having completed tertiary education to at least 40%	33.8%	37.9% (2014)	Target likely to be met
5. Lifting at least 20 million people out of the risk of poverty and social exclusion	1.4 million increase (compared to the 2008 base year)	4.5 million increase (2014)	Target unlikely to be met

APPENDIX 3 - FINDINGS FROM IN-DEPTH REVIEWS BY MEMBER STATE

Belgium is experiencing no macroeconomic imbalances. A weak export and competitiveness performance is coupled with high public indebtedness, which may pose risks going forward. However, recent developments point to a stabilisation of export market shares and a reduction in wage growth. Even though public indebtedness is elevated and not on a firm downward path, which implies vulnerabilities, short-term risks appear contained. Recent policy measures include wage moderation and reductions of social security contributions. To ensure the durability of the correction, structural reforms of the wage-setting framework would be needed. The fiscal effort required to ensure the long-term sustainability of public finances is more demanding in a context of subdued nominal growth.

Bulgaria is experiencing excessive macroeconomic imbalances. The economy is characterised by remaining fragilities in the financial sector and high corporate indebtedness in a context of high unemployment. Although banking sector liquidity and profitability have improved, a more robust assessment of the sector can only be based on the upcoming asset quality review and stress tests. Long-term unemployment has further increased in a context of adjustment issues linked to labour market frictions, while skill mismatches hamper job creation. Looking forward, the plan to reform and develop banking supervision has yet to be fully implemented and improving the efficiency of the insolvency procedure remains a challenge, with legislative proposals in preparation. Furthermore, vulnerabilities in the non-banking sector remain to be addressed.

Germany is experiencing macroeconomic imbalances. The large and persistent current account surplus has cross-border relevance and reflects excess savings and subdued investment in both the private and public sectors. Weak domestic investment hampers potential growth and strong reliance on external demand entails macroeconomic risks in a context of subdued foreign demand. While private consumption has strengthened somewhat, the weakness of investment appears entrenched. Public investment has fallen, despite the available fiscal space and favourable financing conditions, and steps taken to increase public investment are insufficient to meet the infrastructure investment gap. Further action is needed to facilitate conditions for private investment, including by reforming the services sector and improving the efficiency of the tax system.

Estonia is experiencing no macroeconomic imbalances. Rising unit labour costs may expose the country to competitive losses, but are projected to moderate in light of productivity growth and falling real wage growth. Housing prices have risen strongly, although in line with income developments, and the supply of housing is expected to adjust to recovering demand. Nevertheless, further price increases may pose risks for the real economy, which requires attention. Policy efforts to boost productivity and higher value-added exports need to be stepped up and efforts to boost labour supply and ease wage pressures are still at an early stage. Several macro-prudential policies have been implemented with an impact on house prices yet to be assessed.

Ireland is experiencing macroeconomic imbalances. Large stocks of net external liabilities and of public and private debt constitute vulnerabilities, despite improvements. Net external liabilities are on a sharp declining trend, in light of a large current account surplus and competitiveness gains. Public debt and private debt are on a downward trajectory, on the back of favourable growth conditions. Banks are well recapitalised and bank profitability is improving. Non-performing loans are declining from high levels. Despite a strong rebound in property prices in 2014, there is no clear evidence of overvaluation. Nevertheless, the economy remains exposed to potentially significant cyclical swings and external shocks. A broad set of policy measures have been taken, notably during the financial assistance programme, to address key challenges in terms of banking sector repair, insolvency frameworks, the housing market and fiscal sustainability.

Spain is experiencing macroeconomic imbalances. Large stock imbalances in the form of external and internal debt, both public and private, continue to constitute vulnerabilities in a context of high unemployment and have cross-border relevance. The current account balance and cost competitiveness are improving but net external liabilities are not projected to reach prudent levels rapidly. Private sector deleveraging is on track and is now supported by favourable growth conditions, while public debt keeps increasing. Measures have been taken in the financial sector, the corporate and personal insolvency frameworks and the employment protection legislation. However, further action is needed, in particular regarding the wage-setting process, innovation and skills and compliance with the stability and growth pact.

France is experiencing excessive macroeconomic imbalances. Large public debt coupled with deteriorated productivity growth and competitiveness may imply risks looking forward, with cross-border relevance. Public debt keeps increasing and recent developments do not point to a clear upswing in competitiveness and productivity. Although profit margins have increased, no recovery in investment is projected before 2017. Policy measures were taken to reduce the labour tax wedge and policy commitments have recently been stepped up. However, effective structural reform implementation remains essential, including regarding the wage setting system, regulatory impediments to firms' growth, while the ambition of the spending review needs to be stepped up.

Croatia is experiencing excessive macroeconomic imbalances. Vulnerabilities are linked to high levels of public, corporate and external debt in a context of high unemployment. The modest economic recovery is set to ease corporate deleveraging and the improvement in the current account balance should contribute to a reduction in external liabilities, but public debt is expected to continue rising. In the banking sector, non-performing loans remain high and profitability is weak. Further consolidation effort and improvements in fiscal governance are needed. Although measures have been taken to improve the insolvency framework and enhance labour market flexibility, substantial policy gaps remain requiring specific policy actions, in particular regarding governance of state owned enterprises, public administration efficiency and the resolution of non-performing loans.

Italy is experiencing excessive macroeconomic imbalances. High government debt and protracted weak productivity dynamics imply risks looking forward, with cross-border relevance. Despite moderate wage growth, competitiveness remains weak as productivity dynamics have been deteriorating, which limits unit labour cost adjustment. The slow resolution of non-performing loans weighs on banks' balance sheets. High long-term unemployment weighs on growth prospects. Public debt reduction would require higher primary surpluses and sustained nominal growth looking forward. Policy action has been taken to reform labour market institutions, address non-performing loans, public administration, justice and education. Policy gaps remain, especially regarding privatisations, the collective bargaining framework, the spending review, market opening measures, taxation and the fight against corruption.

Hungary is experiencing no macroeconomic imbalances. Although high external debt rollover needs and the share of non-performing loans remain a concern, risks linked to external and internal liabilities have been reduced. The marked reduction in net external liabilities has been driven by high current and capital account surpluses. Credit flows to the private sector remain subdued in a context of low bank profitability. Policy measures have been taken to make the regulatory environment more predictable in the financial sector, lower the tax burden on banks, reduce the proportion of debt held in foreign currency and introduce subsidised lending schemes. The impact of these recent measures on bank lending is still to materialise. Moreover, policy gaps remain regarding non-cost competitiveness, productivity and the overall business environment.

The Netherlands is experiencing macroeconomic imbalances. The large and persistent current account surplus has cross-border relevance. The surplus mainly reflects structural features of the economy and policy settings regarding non-financial corporations. The household sector is characterised by a very large debt stock and deleveraging needs. The current account surplus has narrowed slightly since 2013 due to improved cyclical conditions but household deleveraging contributes to maintaining the current account surplus at its high level. Measures have been taken to support the household deleveraging process, but the phasing-in is slow. A package of tax measures is expected to strengthen consumption and thus contribute to a declining surplus in 2016.

Austria is experiencing no macroeconomic imbalances. Austrian banks' exposure abroad and foreign currency loans imply a potential for adverse spill-overs, also in view of bank capital positions and profit prospects. However, banks' foreign exposures have been reduced while improved capitalisation and risk reduction measures are expected gradually to support the banking sector's lending capacity. The restructuring of financial institutions has had an impact on public finances but is now advancing without the need for additional public support. Supervisory measures have strengthened the risk-bearing capacity and resilience of the domestic banking sector and improved the local funding base and asset quality of operations abroad. Export market shares have deteriorated but are stabilising after years of losses.

Portugal is experiencing excessive macroeconomic imbalances. The large stocks of net external liabilities, private and public debt and a high share of non-performing loans constitute vulnerabilities in a context of elevated unemployment. The current account has adjusted to a small surplus. While households' indebtedness has declined, corporate debt is still weighing on firms' performance. Public debt is expected gradually to decline from a very high level. Policy action has been taken regarding the financial sector, access to finance, insolvency procedures, labour market functioning, education and long-term fiscal sustainability. However, policy gaps persist regarding product and services markets, corporate debt restructuring, fiscal issues and selected areas of the labour market.

Romania is experiencing no macroeconomic imbalances. Risks are linked to the high stock of net foreign liabilities, vulnerabilities of the banking sector and pro-cyclical fiscal policy along with strong wage growth. In a context of strengthened recovery, net external liabilities have declined from a high level. With the support of the Commission, action has been taken to strengthen the financial sector. The banking sector is now well capitalised and liquid but several currently discussed legislative initiatives pose a risk for its stability. Public wages and the minimum wage were increased and tax cuts were implemented. This poses a risk of fiscal policy becoming pro-cyclical.

Slovenia is experiencing macroeconomic imbalances. Weaknesses in the banking sector, corporate indebtedness, and fiscal risks constitute vulnerabilities. The reduction in external liabilities is progressing, the banking sector has stabilised and vulnerabilities in the corporate sector are being addressed through operational and financial restructurings. Deleveraging pressures are easing but still weigh on corporate investment and recovery prospects. The business environment remains hampered by administrative burden. Policy measures have been taken regarding the corporate governance of the "bad bank" and significant progress has been made regarding the governance of state-owned enterprises. Progress on reducing the administrative burden has instead been limited, and the strategy on foreign direct investment has yet to be fully implemented. Further action is needed to put debt on a sustainable downward path.

Finland is experiencing macroeconomic imbalances. Finland has recorded competitiveness losses linked to the decline of key sectors and companies and wage growth above productivity, resulting in a sharp decline in the current account balance. Private debt is large, which may constitute vulnerability, although the financial sector is sound. Cost competitiveness has gradually started to improve and the fall in export market shares has slowed down, while the current account is moving towards a surplus. Deleveraging pressures are expected to remain limited. Moderate wage increases have been agreed by social partners and initiatives have been launched to revive growth in high-tech sectors and to facilitate exports. Recent measures on household mortgages may limit the growth of household indebtedness.

Sweden is experiencing macroeconomic imbalances. High and increasing household debt associated with high and growing house prices in a context of positive credit flows pose risks of disorderly correction with implications for the real economy and the banking sector. No house prices correction has taken place and the current drivers of the growth of house prices will probably remain in place in the near term. Policy measures have been taken in the macroprudential domain, which may however remain insufficient. Overall, policy gaps remain in the area of housing-related taxation, the amortisation of mortgages, the functioning of housing supply and the rental market.

The United Kingdom is experiencing no macroeconomic imbalances. High household sector debt and elevated house price levels as well as the large current account deficits may constitute vulnerabilities. However, household balance sheets are strong in aggregate and both household debt levels and house price growth have fallen since 2014. Moreover, risks associated with the large current account deficit are mitigated by a favourable institutional framework and low foreign currency liabilities, and the deficit is expected to decline as adverse cyclical conditions unwind. Several government initiatives have yet to exert a material impact on the imbalance between housing supply and demand.