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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee (part 2)/Council
Subject:	EFC President Letter: Point on Council Conclusions MIP IDRs

Delegations will find attached the letter from the President of the EFC addressed to the President of the ECOFIN Council on the *Macroeconomic Imbalance Procedure: 2022 In-depth Reviews*.



ECONOMIC AND FINANCIAL COMMITTEE

THE PRESIDENT

1 July 2022
ecfin.cef.cpe(2022)5278041

Mr. Zbyněk Stanjura
President of the Ecofin Council
General Secretariat of the Council of the EU
Rue de la Loi 175
1048 Brussels

Macroeconomic Imbalance Procedure: 2022 In-depth Reviews
Report by the President of the Economic and Financial Committee

Dear President,

In preparation for the Council conclusions on 2022 in-depth reviews, I would like to draw your attention to the main messages from the examination of in-depth reviews in the preparatory committees. For background, annexed to this letter you will find country fiches on 12 Member States subject to 2022 in-depth reviews, summarizing country-specific findings of the discussions in the Economic Policy Committee and its LIME Working Group.

The preparatory discussions recognized that in 2021, the correction of the macroeconomic imbalances continued, after a setback due to the COVID-19 pandemic. Looking forward, the uncertainties associated to the Russian war of aggression in Ukraine, the rise in inflation, the increasing energy and commodity prices, and tightening financial conditions could weigh on the correction of imbalances and could lead to new imbalances. Close monitoring of the evolution of imbalances and the implementation of structural reforms remain crucial. The committees took note that the impact of the rapidly changing economic conditions on the macroeconomic imbalances will be reflected in the upcoming 2023 Alert Mechanism Report in the autumn.

The preparatory committees appreciated the continued high quality of the in-depth reviews and the application of previously discussed analytical tools. They emphasised the importance of ensuring that in-depth reviews provide a comprehensive analysis of macroeconomic imbalances. The committees also noted a need for a special attention to possible effects of the current policy mix of accommodative fiscal policy and the tighter monetary policy with tightening financing conditions on the evolution of imbalances.

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The preparatory discussions underlined the importance of the continued and effective implementation of the Macroeconomic Imbalance Procedure and its central role in the EU economic policy coordination. The discussions recalled that the Macroeconomic Imbalance Procedure should be used in full, including the activation of the Excessive Imbalance Procedure, when appropriate. The committees called for reverting to the pre-COVID timeline of the in-depth reviews, in order to allow for their thorough examination ahead of the preparation of country-specific recommendations under the European Semester. The Commission noted that the European Semester planning would need to take into account the outcome of the economic governance review. The committees will continue discussions on these issues in the context of the economic governance review and the European Semester follow-up discussions in autumn 2022.

I trust this set of issues, alongside the country-specific findings in the annex, will be of benefit to the background of the Council conclusions on the 2022 in-depth reviews under the Macroeconomic Imbalance Procedure.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'T. Saarenheimo', with a long horizontal stroke extending to the right.

Tuomas Saarenheimo

President of the Economic and Financial Committee

GERMANY

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Germany is experiencing imbalances. Vulnerabilities relate to a persistent large current account surplus, which reflects subdued investment relative to savings, and has cross-border relevance. The current account surplus declined only slowly until 2020, and increased in 2021. It remains well beyond the levels suggested by the country's fundamentals, reflecting consumption restraint and persistently subdued investment. Corporate investment has remained below the pre-pandemic level and corporations have continued to post strong net savings. Residential investment has gradually increased from a low level but supply still falls short of housing demand. Existing barriers, including administrative ones, constrain public and private investment. The current account surplus is likely to remain elevated even if expected to decline somewhat in 2022 on account of higher commodity prices. Recent announcements to promote investment are promising and the RRP is geared towards addressing investment bottlenecks. Still, further resources and efforts to tackle investment bottlenecks as well as thorough implementation are key for promoting investment further.

The EPC agrees that Germany is exhibiting macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC acknowledges that the current account surplus remains large and that it reflects subdued investment relative to savings. The current account surplus is likely to remain elevated even if expected to decline somewhat in 2022 in particular on account of higher commodity prices. For supporting domestic demand, Germany has taken measures, including increasing the minimum wage. The ageing society and the reorganisation of supply chains are expected to increase domestic demand. Uncertainties remain substantial, including due to the Russian war of aggression in Ukraine and the energy crisis. The evolution of the house prices suggests that investment in new houses is below what is needed to satisfy demand. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *broadly concurs* with the technical analysis and the main findings of the in-depth review with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 review appropriate. *The LIME broadly agrees* that the in-depth review made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are generally supportive of the assessment of imbalances. LIME *finds* that the focus of the in-depth review on investment needs and bottlenecks is *appropriate*. Further analysis could be warranted on how the minimum wage increase, aggregate investment, Germany's fiscal federal structure, or demographic change may affect consumption, imports and the current account, as well as on macroeconomic risks associated to boom-bust-cycles in the housing market and their implications. The implications of the expected normalisation of monetary policy may require further attention. The use of the current account "norms", can provide useful information, but deviations from the "norm" should be interpreted with caution and some measure of uncertainty.

IRELAND

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Ireland, identified with imbalances in 2021, is found to experience no imbalances. Important progress has been made in reducing government and private indebtedness as well as net external liabilities, both before and since the pandemic. The reductions of the debt ratios remain significant, albeit smaller, when national output is adjusted for the effects of the operations of multinational enterprises registered in Ireland. Both private and government indebtedness are expected to continue falling, with the external position strengthening further. Irish banks continued reducing their non-performing loans ratio. High house price growth continues to be a challenge for housing affordability, but risks to macroeconomic stability appear contained so far. While its direct impact might be limited due to its comparatively small size, the RRP has the potential to help strengthen the fundamentals of the economy further.

The EPC agrees that Ireland no longer exhibits macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that public, private and external debt-to-GDP ratios decreased substantially in recent years. Irish banks continued reducing their non-performing loans ratio. House prices accelerated in 2020 and continued to increase in 2021. Housing affordability remains a challenge for the country, which may affect Ireland's ability to attract mobile skilled labour and result in wage pressures. The unemployment rate has declined rapidly and reached pre-crisis levels; some sectors (construction) face labour shortages. Ireland has taken measures for increasing labour market flexibility, improving the business environment and increasing the effectiveness of the public administration. Uncertainties remain substantial, including due to the Russian war of aggression in Ukraine and the energy crisis. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on the housing market is *appropriate*. The large multinational enterprise sector in Ireland continues to affect the Irish statistics. For assessing underlying trends in the domestic economy and country-specific factors, the analysis incorporated the modified metrics developed by Ireland's National Statistical Institute. Further analysis could be useful on the possible persistence of supply constraints, low bank profitability and competitiveness in the retail banking sector and the potential vulnerabilities related to the non-bank financial sector, including the fund subsector, risks in the housing market, the war and its spillovers, as well as a forward looking analysis of possible effects of monetary policy changes.

GREECE

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Greece is experiencing excessive imbalances. Vulnerabilities relate to high government debt, incomplete external rebalancing and high non-performing loans in a context of low potential growth and high unemployment. The government debt-to-GDP ratio resumed its decline, which is projected to continue thanks to improving budgetary outcomes and economic growth. The current account deficit still reflects the incomplete recovery from the sharp fall in foreign tourism in 2020 and is expected to remain clearly negative this year and next. The net international investment position remains also largely negative, to a substantial extent reflecting government debt mostly held by official sector creditors. It may however improve expressed as a share of GDP thanks to economic growth and inflows of significant RRF funds. Despite substantial progress, the share of non-performing loans remains high and hampers banks' ability to provide credit to firms and households. Relevant measures have been taken to facilitate economic adjustment and the unwinding of vulnerabilities. The successful implementation of the RRP represents a major opportunity to address vulnerabilities and enhance potential growth.

The EPC agrees that Greece is exhibiting excessive macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that public, private and external debt-to-GDP ratios decreased after the COVID-19 crisis. Short-term interest rate fluctuations do not have a sizeable effect on debt sustainability and need to be assessed with developments in other macroeconomic variables such as inflation. However, uncertainties remain substantial including due to the Russian war of aggression in Ukraine and high energy prices. The impact of tightening financing conditions and the subsequent increases in real interest rates might create headwinds to private consumption and investment going forward. The current account deficit is large and vulnerable to risks. Foreign direct investment inflows are increasing, supported by reforms in improving the business environment, reducing administrative burden and increasing the effectiveness of the public administration, as well as investments in research and development. Despite substantial progress, the share of non-performing loans is high and hampers banks' ability to provide credit to the economy. Sovereign bond volatility may constitute a potential short-term vulnerability. Substantial progress has been made in increasing the resilience of the labour market. Even though the unemployment rate notably of the youth remains elevated and female participation is low, the decrease in women and youth unemployment, in 2021, was more pronounced in percentage terms than the reduction in the headline unemployment rate. Further upskilling and reskilling of the labour force is ongoing, also in the context of digital and green transitions. The insolvency framework reform remains important. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on external imbalances is *appropriate*. Further analysis could be warranted on more recent developments and on the impact of structural reforms on potential growth and productivity.

SPAIN

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Spain is experiencing imbalances. Vulnerabilities relate to high external, government and private debt, in a context of high unemployment, and have cross-border relevance. In 2021, debt-to-GDP ratios resumed their declining trends observed before the pandemic and are forecast to fall further this year and next. The current account records a small surplus and the net international investment position has reached its best reading since the mid-2000s. Yet private debt remains higher than before the COVID-19 crisis, still exceeding prudential levels, while the high government debt-to-GDP ratio remains well above its pre-pandemic level. Non-performing loans continued to decrease, but some risks remain especially in energy-intensive sectors and those that were previously hit hard by the COVID-19 crisis. Unemployment started to decrease again in 2021, but labour market segmentation and youth unemployment remain high, although past and recent labour market reforms and the continued implementation of the RRP will help address Spain's remaining vulnerabilities.

The EPC agrees that Spain is exhibiting macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that public, private and external debt-to-GDP ratios decreased after the COVID-19 crisis, although private and government debt ratios remain above their pre-pandemic levels. Nonetheless, the increase in private debt levels since the start of the pandemic has been partially mitigated by a parallel build-up of liquidity buffers by Spanish non-financial corporations. The rising prices of energy and raw materials may add to macroeconomic risks. Despite the recovery in tourism in 2022, substantial uncertainties remain, including due to the Russian war of aggression in Ukraine and the ongoing energy crisis; however Spain has a more limited exposure towards Russia than other European peers. Fiscal sustainability risks are low in the short term but remain elevated in the medium and long term. Spain is taking measures to improve the quality of public finances, including conducting spending reviews. Risks associated to the deterioration in asset quality and the increase in non-performing loans seem limited in the short term but should continue to be closely monitored. Spain has made further progress in reducing labour market segmentation and unemployment. The reform of insolvency proceedings is advancing but further reform efforts may be needed. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on private indebtedness is *appropriate*. Further analysis could be warranted on the evolution of stage-2 loans and the effect of the pandemic-related government measures on corporate credit and liquidity, also at sectoral level and by firm-size.

FRANCE

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

France is experiencing imbalances. Vulnerabilities relate to high government debt and weak competitiveness, which have cross-border relevance, in a context of low productivity growth. The COVID-19 crisis brought about a sizeable increase in the already high government debt, but with the economic recovery, the government debt-to-GDP ratio edged down in 2021 and is forecast to keep falling this year and next, while remaining well above its pre-pandemic level. Private indebtedness has kept growing in recent years and is exceeding prudential levels, although risks relating to increased corporate indebtedness are somewhat mitigated by a parallel build-up of liquidity buffers. Underlying productivity dynamics have remained stable over time. Exports market shares, which had broadly stabilised in earlier years, decreased sharply during the pandemic with key export sectors being severely hit but a sizeable recovery is projected for 2022 and 2023. Cost competitiveness, as well as productivity, are set to benefit from recent and upcoming reforms, including a continued strong implementation of the RRP.

The EPC agrees that France is exhibiting macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that both government and gross private debt-to-GDP ratios increased substantially with the COVID-19 crisis and, although having started to edge down in 2021, they remain well above pre-pandemic levels. Uncertainties remain substantial, including due to the Russian war of aggression in Ukraine and the energy crisis. The deterioration of France's competitiveness and productivity during the COVID-19 crisis is expected to be temporary in light of the gradual recovery of key sectors, including the tourism and the aircraft industries. France has introduced broad-based reforms for improving its competitiveness, including by enhancing the labour market flexibility, reducing production taxes, making the public administration and the judicial system more effective, strengthening financial capacity of small and medium-sized enterprises, improving the educational and training outcomes, and complemented with significant investment in improving skills and in promoting technological innovation. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on private indebtedness is *broadly appropriate*. Further analysis could be warranted on the interdependence of public debt sustainability and private debt developments, and the impact of energy prices and rising interest rates on public and private debt and the external sector.

CROATIA

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Croatia, identified with imbalances in 2021, is found to experience no imbalances. Important progress has been made in reducing private indebtedness and net external liabilities. General government debt remains high but has resumed the downward trajectory that delivered marked improvements before the pandemic. The banking sector remains stable and liquid, with a decreasing non-performing loans ratio. Potential output growth has increased, building on strong policy action, and a further strengthening based on a strong implementation of the RRP can address remaining vulnerabilities. On current forecasts, both private and government indebtedness are expected to continue falling with the external position strengthening further benefiting also from the RRF funds.

The EPC agrees that Croatia no longer exhibits macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that public, private and external debt-to-GDP ratios decreased notably over recent years. The banking sector remains stable and liquid, and potential output growth has increased. However, uncertainties remain substantial, including due to the Russian war of aggression in Ukraine and the energy crisis. Croatia's economy is well aligned with the euro area, facilitating a smooth euro adoption. Cost competitiveness has improved over the years. Reforms and investments under the Recovery and Resilience Facility will further improve Croatia's resilience to future crises. The Croatian economy has recovered rapidly and the outlook for potential growth has improved. The most recent growth projections, while revised downwards, remain positive and supportive for a further reduction of debt stocks. Potential growth remains rather subdued for a catching-up economy. Debt developments and the vulnerabilities related to business environment and residential real estate require further monitoring. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR analysis is *appropriate*. Despite reduced vulnerabilities, debt developments could warrant further analysis, especially given the remaining uncertainties.

ITALY

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Italy is experiencing excessive imbalances. Vulnerabilities relate to high government debt and weak productivity growth, in a context of labour market fragilities and some weaknesses in financial markets, which carry cross-border relevance. Persistent low productivity growth has been a key factor behind Italy's protracted weak GDP growth, which has dampened government debt deleveraging, dented employment opportunities and impacted banks' balance sheets. The government debt-to-GDP ratio started to decline in 2021 and is forecast to further decline but remains a risk for fiscal sustainability, the financial sector and economic growth. Despite improvements in the labour market, low participation rates persist. Significant improvements have been achieved in reducing non-performing loans, although the sovereign-bank nexus reinforced over the COVID-19 crisis and remains a challenge. In addition, the banking sector may face challenges as the impact of the phasing-out of temporary support measures in response to the pandemic crisis fully unfolds. The RRP is addressing vulnerabilities, including by spurring competitiveness and productivity. Nonetheless, the growth-enhancing effect of investment and reforms is likely to take time to unfold and crucially depends on swift and sound implementation.

The EPC agrees that Italy exhibits excessive macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that the public debt-to-GDP ratios decreased after the COVID-19 crisis. Persistent inflationary pressures could eventually negatively affect debt servicing cost and public finances in general. Persistent low productivity growth has been a key factor behind Italy's protracted weak GDP growth. Italy has frontloaded a number of growth-enhancing reforms and investments, including as regards the civil justice system, education and training, digitalisation of public services, taxation, and research and development. Some challenges remain in the labour market, although permanent contracts are increasing and above the levels registered in 2019. Sovereign bond volatility may constitute a potential short-term vulnerability. Uncertainties remain substantial, including those due to the Russian war of aggression in Ukraine and the high energy prices. The ratio of non-performing loans is only slightly above the euro area average. The long maturity of public debt mitigates fiscal sustainability risks. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on the financial sector is *appropriate*. Further and deeper analysis could be warranted on the impact of labour market deficiencies and regional disparities on potential growth. The implications of demographic change, impact of ageing and of regional disparities, the increase in inflation and tightening financing conditions for fiscal sustainability and household income could be explored more extensively. Italy's recovery and resilience plan is widely devoted to fill the regional gaps and to mitigate the impact of ageing.

CYPRUS

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Cyprus is experiencing excessive imbalances. Vulnerabilities relate to high government and private debt, large current account deficits and a still high stock of non-performing loans. The government and private debt-to-GDP ratios declined again thanks to a strong economic rebound in 2021. Non-performing loans of the banking sector declined substantially thanks to large sales of such loans to credit acquiring companies but remain high. The current account deficit is large despite an improvement in 2021, and moreover is projected to widen in 2022 and only slowly narrow thereafter, thereby not ensuring a prudent net international investment position over the medium term. Government and private debt-to-GDP ratios are expected to further improve, in part on the back of economic growth. However, the economic outlook for 2022 is surrounded by heightened uncertainty related to the impact of Russia's invasion of Ukraine in view of particularly sizeable trade of services exposures. If implemented timely and effectively, the RRP has the potential to contribute to a significant reduction of vulnerabilities, but additional policy action is warranted.

The EPC agrees that Cyprus is exhibiting excessive macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that public, private and external debt-to-GDP ratios decreased after the COVID-19 crisis. Even though the increasing interest rate environment constitutes a significant downside risk, the public debt is expected to steadily decline in the foreseeable future. Large current account deficits and a still high stock of non-performing loans remain as concerns, despite the significant decline of the non-performing loan ratio to single digits. Moreover, uncertainties remain substantial, including due to the Russian war of aggression in Ukraine and the energy crisis in view of particularly sizeable trade of services exposures to Russia and energy import dependency. The enhancement of payment discipline, to encourage private sector savings and to limit excessive borrowing in the country, remains an important area for policy attention. The economy of Cyprus weathered well the COVID-19 crisis, although the tourism sector is still recovering and lagging behind its 2019 levels. To this regard, there is an ongoing implementation of a tourist strategy to diversify the tourist product and reduce over dependency on specific countries. Cyprus is taking broad-based measures for diversifying its economy, including reducing its dependency on oil imports, strengthening its export capacity and reducing public debt. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on private debt and external imbalances is *appropriate*.

THE NETHERLANDS

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

The Netherlands is experiencing imbalances. Vulnerabilities relate to high private debt and a large current account surplus, which carry cross-border relevance. From a sector perspective, high savings and low domestic investment of non-financial corporations are the main structural drivers of the high and persistent current account surplus, which is well beyond the levels suggested by the country's fundamentals and increased further in 2021. Part of the external surplus and its recent dynamics are linked to operations of some large multinational corporations. Going forward, the surplus will likely remain high as its main drivers remain in place. Private sector debt remains high on account of both high household debt and corporate debt, the latter partly on account of intra-group cross-border debt of multinationals. High household debt makes households more vulnerable to shocks, given that strong house price increases have contributed to rising debt and house prices appear to be overvalued. Household debt is expected to remain elevated in light of continued house price growth and of distortions in the housing market that favour debt-financed home ownership in combination with a shortfall in housing supply. Limited policy steps have been taken but more needs to be done.

The EPC agrees that the Netherlands exhibits macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that private sector debt remains high on account of both high household debt and corporate debt and that housing market distortions contribute to household debt. High household savings and low domestic investment of non-financial corporations are the main structural drivers of the high and persistent current account surplus. The budgetary impulse and investment plans would contribute to increasing domestic demand. Uncertainties remain substantial, including due to the Russian war aggression in Ukraine and the energy crisis. The labour market presents some vulnerabilities linked to the high level of self-employed and workers with flexible contracts that were particularly hit during the pandemic.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on the housing market is *appropriate*. Further analysis could be warranted on the impact of the relocation of "Shell" and government investment programme on the current account; the commercial real estate market; loans subject to moratoria or public guarantees; sectoral differences in the borrowing of non-financial corporations and the impact of energy prices; the impact of high inflation and rising interest rates on household balance sheets and of high commodity prices; and the impact of applying macro prudential policies to address private debt and house price issues.

PORTUGAL

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Portugal is experiencing imbalances. Vulnerabilities relate to high private, government and external debt in a context of low productivity growth. Non-performing loans have fallen considerably from high levels. After a temporary reversal in 2020 due to the COVID-19 crisis, those vulnerabilities resumed their downward trajectory in 2021. The current account balance turned negative in 2020 and 2021, mainly due to the pandemic-driven shock in the tourism sector, while the net international investment position improved considerably already in 2021, even beyond its pre-pandemic level. The private sector and government debt-to-GDP ratios resumed their downward trends in 2021 but remain above pre-pandemic levels and the former is still exceeding prudential levels. Going forward, private, government and external debts are expected to continue narrowing on the back of economic growth. The external position will also directly benefit from the RRF funds. Policy progress has been made to address imbalances and a successful implementation of the RRP can help in further narrowing them, but policy challenges remain.

The EPC agrees that Portugal exhibits macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that public, private and external debt-to-GDP ratios decreased after the COVID-19 crisis. However, uncertainties remain substantial, including due to the Russian war of aggression in Ukraine and the high energy prices. The Portuguese banking system remains stable and non-performing loans declined to close to euro area average and continue to fall. Housing prices increased in 2021. Portugal has introduced a programme for promoting the development of the rental market. The Portuguese recovery and resilience plan supports policies on education, the digital transition and skills improvement, which can increase productivity growth. The projects related to the recovery and resilience plan that aim at promoting renewable energy could mitigate the negative implications of the rise in energy prices on the current account balance. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on external imbalances is *appropriate*. Further analysis could be warranted on house price developments and possible implications of the slow-down in economic growth and second-round effects of the hike in energy prices, including for the tourism sector, on the effects of the phasing out of COVID-19 support measures, rising inflation and possible changes in monetary policy on debt levels and non-performing loans, on the historic context of the evolution of the country's imbalances.

ROMANIA

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Romania is experiencing imbalances. Vulnerabilities relate to external accounts, linked to large fiscal deficits, and to competitiveness issues that are re-emerging. The high current account deficit further worsened in 2021 and is not forecast to improve this year or next. Large fiscal deficits pre-date the COVID-19 crisis and have driven up the current account deficit which poses risks to external debt sustainability. Sovereign borrowing costs have increased since early 2021. The expected acceleration in wages could weigh further on cost competitiveness. Nominal depreciation could mitigate competitiveness losses but add to inflationary pressures and increase the burden of serving debts in foreign currencies, which are significant for the government and the private sector. The negative net international investment position is expected to remain below its pre-pandemic levels. The external position is expected to benefit from significant RRF funds but external financing can otherwise become more challenging amid tighter global financial conditions. Recent policy initiatives, including the successful implementation of Romania's RRP, can address some vulnerabilities, still further action is needed to improve competitiveness and potential growth.

The EPC agrees that Romania exhibits macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that external accounts, linked to large fiscal deficits, remain a concern and that competitiveness issues are re-emerging after some subdued developments during the pandemic. Government debt is still moderate. Uncertainties remain substantial, including due to the Russian war of aggression in Ukraine and the energy crisis. The pension reform and spending reviews remain central for improving the quality of public finances. Financing of the significant external borrowing needs could become more challenging as global financing conditions tighten. The labour market reaction to the recovery from the recession is expected with some delay; export market shares have increased despite a recent slowdown. At the same time, high nominal wage growth poses a risk for the export competitiveness of the economy while a new approach to set the statutory minimum wage is being prepared. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on external imbalances is *appropriate*. Further analysis could be warranted on the large uncertainty, much on the account of the Russian war of aggression in Ukraine and a possible further deepening of trade sanctions.

SWEDEN

Commission's European Semester 2022 Spring Package Communication, 23 May 2022: extract

Sweden is experiencing imbalances. Vulnerabilities relate to high and rising house prices and high household indebtedness. In 2021, house prices moved further away from fundamental values with supportive financial conditions continuing to fuel housing demand. High household debt exposes Sweden to the risk of adverse shocks and a disorderly correction of housing prices, with potential harmful implications for the real economy and the banking sector. Private debt has risen further, a large share of which is concentrated in real estate, both commercial and housing, and most of household mortgage debt is at variable interest rates. Policy measures have not sufficiently addressed vulnerabilities relating to housing debt and potential house price overvaluations. Tax incentives for debt-financed housing remain, along with shortages in supply and identified shortcomings in the functioning of the rental market. Measures in the RRP only address the vulnerabilities in a partially satisfactory manner.

The EPC agrees that Sweden exhibits macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure.

The EPC *acknowledges* that house prices are high and continued to rise quickly until March 2022, followed by more subdued market outcomes. Household indebtedness remains high. Uncertainties as regards the economic outlook remain substantial, including due to the Russian war of aggression in Ukraine and the energy crisis. Tax incentives for property ownership and mortgage debt remain important structural drivers behind household debt growth and overvalued house prices. A shift from labour to property taxation could reduce vulnerabilities and increase welfare. High corporate assets, large equity cushions, high capitalisation of banks and a low non-performing loans ratio mitigate to some extent risks arising from high private debt. Changes in borrowers' willingness to move away from variable interest rates could shield borrowers somewhat from mortgage rate increases. Measures to defer capital gains taxes aim at increasing housing supply and improving mobility on the housing market. Sweden has introduced macroprudential measures for addressing potential vulnerabilities. The implementation of the structural reforms in the recovery and resilience plan and beyond would contribute to increasing the resilience of the economy and to enhancing potential growth.

In supporting the EPC discussion, the LIME Working Group *concurs* with the technical analysis and the main findings of the IDR with regard to the gravity and evolution of imbalances and considers the topics identified in the 2022 report appropriate. LIME *broadly agrees* that the IDR made use of the appropriate analytical tools to support the Commission's analysis and that these methodologies are supportive of the assessment of imbalances. LIME *finds* that the focus of the IDR on the housing market and property taxation is *appropriate*. Some model-based assessment of Swedish house prices do not indicate overvaluation. The impact of local property fees on the availability of buildable land is difficult to quantify.