BRIEFING

Member States with Excessive Macroeconomic Imbalances

This note provides an overview on the state-of-play of the surveillance of the three Member States that have been assessed as part of the 2018 European Semester cycle as experiencing excessive macroeconomic imbalances in the context of the Macroeconomic Imbalance Procedure. Separate notes describe the state of play of the MIP implementation and the MIP procedure.

Introduction

In March 2018, the European Commission (COM) concluded that three Member States are in a situation of "excessive macroeconomic imbalances": **Italy**, **Cyprus and Croatia.**

Table 1 below shows that:

- Italy and Croatia are in a situation of excessive macroeconomic imbalances since 2014;
- Cyprus is experiencing excessive macroeconomic imbalances since it exited its macro-economic adjustment programme in 2016;
- The following Member States reduced their excessive macroeconomic imbalances: Spain (in 2013), Slovenia (in 2014) and Bulgaria, France and Portugal (in 2017).

More specifically, the COM noted that "*Cyprus, Croatia and Italy are identified, as in 2017, to be experiencing excessive imbalances. Imbalances are being reduced in Croatia and Italy, supported by a combination of reforms, favourable economic conditions and a reduction of risks in the banking sector. There is however a need for more determined policy implementation, notably in Croatia. No tangible improvement is recorded in Cyprus, where policy implementation has also been rather limited.*"

Table 1: Member States experiencing excessive macroeconomic imbalances, 2012-2018

2012	2013	2014	2015	2016	2017	2018
-	ES	HR	BG	BG	BG	HR
	SI	IT	FR	FR	FR	IT
		SI	HR	HR	HR	CY
			IT	IT	IT	
			PT	PT	PT	
				CY	CY	

Source: EGOV based on European Commission assessments.

ECONOMIC GOVERNANCE SUPPORT UNIT
Author: Alice Zoppè
Directorate-General for Internal Policies
PE 602.083 - September 2018

EN

In May 2018, the Council agreed with the Commission's view that excessive imbalances exist in these three Member States, and reiterated that "*the MIP should be used to its full potential and in a comprehensible way, including with the excessive imbalance procedure applied where found appropriate by the Commission and the Council.*" Furthermore, the Council reemphasized "*that whenever the Commission concludes that a Member State is experiencing excessive imbalances, but does not propose to the Council the opening of the excessive imbalance procedure, it should clearly and publicly explain its reasons.*".

The Commission did not open a procedure for excessive macroeconomic imbalances for any of these countries. Member States with macroeconomic imbalances are however subject to "specific monitoring", which is a form of "*intensified dialogue between the European Commission and national authorities that aims to help EU countries address macroeconomic imbalances that could negatively affect their own economic stability or that of the euro area or the EU*". Specific monitoring is adapted to the scope of the challenges and the severity of the imbalances. Furthermore, their Country Specific Recommendations (CSRs) may be underpinned by the preventive arm of the MIP legal basis (MIP-CSRs).

In fact, since 2015, the MIP underpinned most of the CSRs addressed to the MS experiencing excessive imbalances. However, the three Member States under consideration made unsatisfactory progress as regards the implementation of the 2017 CSRs (under the MIP), as shown in table 2.

Table 2: Commission's assessment of the 2017 CSRs for Member States with excessive imbalances

	Joint SGP and MIP legal base	MIP legal base			
HR	CSR1	CSR2	CSR3	CSR4	CSR5
IT	CSR1	CSR2	CSR3	CSR4	
CY	CSR1	CSR2	CSR3	CSR4	

Source: EGOV based on European Commission assessments (March 2018).
Note: The assessment grid of CSRs implementation is as follows: full/substantial progress, some progress and limited/no progress.

The remaining part of this document presents, for each country under consideration:

- a summary of the specific imbalances identified by the Commission,
- an overview of the CSRs having the MIP as a legal basis and the Commission assessments of their implementation, over the years;
- selected information on the "specific monitoring" activities performed by the Commission;
- the CSRs adopted by the Council in July 2018, underpinned by MIP.

Most of the information is based on the annual "Country reports" published by the Commission, which provide an in-depth-review of the economic situation and aim at establishing whether macroeconomic imbalances exist, including the possible spill-overs to other Member States; these reports also include an assessment of the implementation of the CSRs adopted in the previous Semester cycles.

Annex 1 presents the MIP scoreboard that launched the 2018 MIP round (with data referring to 2016). All the MIP-based CSRs adopted by the Council over years and addressed to Member States, together with the assessment of their implementation, are available at the EGOV CSRs online database.

Croatia

Croatia has been experiencing excessive macroeconomic imbalances since it entered the EU and was first involved in the European Semester in 2014. Croatia was under Excessive Deficit Procedure from 2013 to 2017; it is now under the preventive arm of the Stability and Growth Pact, has overachievied its Medium Term Objective, and is subject to debt rule.

In November 2017, its MIP scoreboard (see Annex 1) showed that the following indicators had values above the threshold: the Net International Investment Position, the Government Debt, and the unemployment rate.

In the context of **specific monitoring**, the Commission also published the latest "Review of progress on policy measures relevant for the correction of macroeconomic imbalances" for Croatia in November 2017 (previous analogous reports were published in November 2014, February 2015, December 2015 and December 2016).

The Commission published in March 2018 the country report for Croatia, where it identifies its main vulnerabilities as linked to high levels of public, private and external debt - all largely denominated in foreign currency - in a context of low potential growth. The report also presents the developments and the policy initiatives undertaken for the correction of the imbalances identified in the 2017 Country Report and targeted by the 2017 country-specific recommendations.

The table below synthetizes the policy areas addressed by the MIP-CSRs from 2014 to 2017 and the assessment of their implementation.

Table: Implementation of 2014, 2015, 2016 and 2017 MIP-CSRs for Croatia

2014			2015			2016			2017		
CSR	**Policy area**	**Progress**	**CSR**	**Policy area**	**Progress**	**CSR**	**Policy area**	**Progress**	**CSR**	**Policy area**	**Progress**
1	Fiscal policy	Limited	**1**	Fiscal policy	Limited	**1**	Fiscal policy EDP	Limited	1	Fiscal policy	Limited
2	Pension and health care systems	Limited	**2**	Pension system	Limited	**2**	Pension and social protection systems	No	2	Pension and social protection systems	Limited
3	Labour market	Some	**3**	Labour market	Limited	**3**	SOE and PA	Limited	3	Education	Limited
4	Tax benefits	Some	**4**	SOE and PA	Limited	**4**	Business environment	Limited	4	PA	No
5	Business environment	Limited	**5**	Business environment	Limited	**5**	Judicial system and NPLs	Limited	5	SOE, Business environment and judicial system	Limited
6	SOE - Public properties	Limited	**6**	Insolvency frameworks	Some						
7	Insolvency frame-works	Limited									
8	Financial sector	Substan-tial									

Sources: EGOV elaboration based on CSRs adopted by the Council and COM Country Reports.
SOE: State Owned Enterprises. PA: Public Administration.

The country report includes an overview table (p. 16) of the reforms relevant in the context of the MIP, focussing on the main imbalances. For each of the following domains, the Commission presents an assessment of the gravity of the challenge, the evolution and prospects, as well as the policy response:

- Public debt
- Household and corporate debt and the financial sector
- External liabilities and trade performance
- Potential output

In April 2018, Croatia submitted its 2018 National Reform Programme and its 2018 Convergence Programme.

The Country report, the National Reform Programm and the Convergence programme (together with its assessment by the Commission), constituted the basis for the four CSRs adopted by the Council in July 2018.

All the following CSRs addressed to Croatia are underpinned by MIP:

*1. Strengthen the **fiscal framework**, including by strengthening the mandate and independence of the Fiscal Policy Commission. Introduce a recurrent property tax.*

*2. Discourage early retirement, accelerate the transition to a higher statutory retirement age and align **pension** provisions for specific categories with the rules of the general scheme. Deliver on the reform of the **education and training** system to improve its quality and labour market relevance for both young people and adults. Consolidate **social benefits** and improve their poverty reduction capacity.*

*3. Reduce the territorial fragmentation of the **public administration**, streamline the functional distribution of competencies and enhance the capacity to design and implement public policies. In consultation with social partners, introduce harmonised wage-setting frameworks across the public administration and public services.*

*4. Improve corporate governance in **state-owned enterprises** and intensify the sale of state owned enterprises and non-productive assets. Significantly reduce the **burden on businesses** arising from parafiscal charges and from cumbersome administrative and legislative requirements. Enhance **competition in business** services and regulated professions. Reduce the **duration of court proceedings** and improve electronic communication in courts.*

Italy

Italy has been experiencing excessive macroeconomic imbalances since 2014.

Italy was under Excessive Deficit Procedure from 2009 to 2013. Nevertheless, since 2015 the Commission has prepared reports - under art. 126(3) of the Treaty - that analyse the compliance with the debt rule. The latest report (of May 2018) concludes "*Overall, the analysis suggests that the debt criterion ... should be considered as currently complied with, and that an EDP is thus not warranted at this stage, ... However, the adjustment in 2018 appears inadequate to ensure compliance with the adjustment path towards the Medium Term Objective in 2018 based on the Commission 2018 spring forecast. The Commission will reassess compliance on the basis of the ex-post data for 2018 to be notified in Spring 2019*." The Commission and the Council (in the country-specific recommendations endorsed by the European Council) state that "*the need for action to reduce the risk of adverse effects on the Italian economy and on the economic and monetary union, given the size and cross-border relevance of Italy's economy, is particularly important".* Concerning the fiscal position (in terms of the SGP implementation), Italy is not yet at its MTO and is subject to the debt rule.

In November 2018, its MIP scoreboard (see Annex 1) showed two indicators with values above the threshold: Public debt and Unemployment rate.

In the context of **specific monitoring**, the Commission published the "Review of progress on policy measures relevant for the correction of macroeconomic imbalances" for Italy in December 2017 (previous analogous reports were published in November 2014, February 2015, December 2015 and December 2016).

The Commission published in March 2018 its latest country report, which included the in-depth review of Italy's macroeconomic imbalances. The report presents the developments and the policy initiatives undertaken for the correction of the imbalances identified in the 2017 country report, and targeted by the 2017 country-specific recommendations. The table below synthetizes the policy areas addressed by the MIP-CSRs from 2014 to 2017 and the assessment of their implementation.

The latest country report includes an overview table (p. 21) of the reforms relevant in the context of the MIP, focussing on the main imbalances. For each of the following domains, the Commission presents an assessment of the gravity of the challenge, the evolution and prospects, as well as the policy response:

- Productivity and competitiveness
- Public debt
- Labour market participation and unemployment
- Banks' asset quality

In April 2018, Italy submitted its 2018 National Reform Programme and its 2018 Stability Programme.

Table: Implementation of 2014, 2015, 2016 and 2017 MIP related CSRs for Italy

2014			2015			2016			2017		
CSR	Policy area	Progress	CSR	Policy area	Progress	CSR	Policy area	Progress	CSR	Policy area	Progress
1	Fiscal policy	Limited	1	Fiscal policy	Limited	1	Fiscal policy	Some	1	Fiscal policy	Some
2	Tax system	Some	2	Transport sector and management of EU funds	Some	2	PA, public companies and civil justice	Limited	2	Civil justice, corruption, competition	Some
3	PA and civil justice	Limited	3	PA and civil justice	Some	3	NPL, insolvency and debt collection frameworks	Limited	3	NPL, insolvency law	Some
4	Banking sector and NPL	Some	4	Banking sector and NPL	Substantial	4	Labour market policies and social system	Some	4	Labour market and social spending	Limited
5	Labour market and social protection system	Some	5	Labour market and education	Substantial	5	Business environment and competition	Limited			
6	Education and research	Some	6	Business environment	Limited						
7	Business environment	Limited									
8	Transport and energy	Limited									

Sources: EGOV elaboration based on the CSRs adopted by the Council and COM Country Reports. SOE: State Owned Enterprises. PA: Public Administration.

The Country report, the National Reform Programm and the Convergence programme (together with its assessment by the Commission), constituted the basis for the four CSRs adopted by the Council in July 2018. All the CSRs adopted by the Council are underpinned by MIP:

*1. Ensure that the nominal growth rate of **net primary government expenditure** does not exceed 0,1 % in 2019, corresponding to an annual structural adjustment of 0,6 % of GDP. Use windfall gains to accelerate the **reduction of the general government debt ratio**. Shift **taxation away from labour**, including by reducing tax expenditure and reforming the outdated cadastral values. Step up efforts to tackle the shadow economy, including by strengthening the compulsory use of e-payments through lower legal thresholds for cash payments. Reduce the share of **old-age pensions** in public spending to create space for other social spending.*

*2. Reduce the length of **civil trials** at all instances by enforcing and streamlining procedural rules, including those under consideration by the legislator. Achieve more effective prevention and repression of **corruption** by reducing the length of criminal trials and implementing the new anti-corruption framework. Ensure enforcement of the new framework for **publicly-owned enterprises** and increase the efficiency and quality of local public services. Address restrictions to **competition**, including in services, also through a new annual competition law.*

*3. Maintain the pace of reducing the high stock of **non-performing loans** and support further bank balance sheet restructuring and consolidation, including for small and medium-sized banks, and promptly implement the **insolvency reform**. Improve market-based access to **finance for firms**.*

*4. Step up implementation of the reform of **active labour market policies** to ensure equal access to effective job-search assistance and training. Encourage labour market participation of women through a comprehensive strategy, rationalising family-support policies and increasing the coverage of childcare facilities. Foster **research, innovation, digital skills and infrastructure** through better-targeted investment and increase participation in vocational-oriented tertiary education.*

Cyprus

Cyprus has been experiencing excessive macroeconomic imbalances since 2016, when it successfully exited the financial support programme.

Cyprus was under Excessive Deficit Procedure from 2010 to 2016, and it is now in the Preventive arm of the SGP. It is overperforming its Medium Term Objective and is subject to the transitional debt rule.

In November 2017, its MIP scoreboard (see Annex 1) showed the following indicators with values above the threshold: Net international investment position, Real exchange rate, Private sector debt, Public debt, Unemployment rate and Activity rate.

The Commission carries out **specific monitoring** for Cyprus in the context of the Post-Programme Surveillance, which is performed for countries that received financial assistance, until they have repaid 75% of the loan. The latest "Post programme surveillance report" was published in December 2017 (the previous one was published in December 2016); it included an overview of the reforms relevant in the context of the MIP, and underpinned by the CSRs.

The Commission published in March 2018 the country report for Cyprus, with the in-depth review of its macroeconomic imbalances. The report presents the developments and the policy initiatives undertaken for the correction of the imbalances identified in the 2017 Country Report and targeted by the 2017 CSRs. The table below synthetizes the policy areas addressed by the MIP-CSRs in 2016 and 2017 and the assessment of their implementation.

Table: Implementation of 2016 and 2017 MIP related CSRs for Cyprus

2016			2017		
CSR	Policy area	Progress	CSR	Policy area	Progress
1	Fiscal policy	Limited	1	Fiscal policy	Limited
2	Insolvency and foreclosure framework	Limited	2	Judicial system	Limited
3	Treatment of Non-Performing-Loans	Some	3	Financial sector and NPLs	Limited
4	Business environment, privatisation and access to finance	Some	4	Strategic investments and privatisation plan	Limited
5	Employment services; hospitals and health care	Limited			

Sources: EGOV elaboration based on CSRs adopted by the Council and COM Country Reports.

The report includes an overview table (p. 22) of the reforms relevant in the context of the MIP, focussing on the main imbalances. For each of the following domains, the Commission presents an assessment of the gravity of the challenge, the evolution and prospects, as well as the policy response:

- External imbalances
- Private debt
- Public debt
- Financial Sector
- Potential growth
- Unemployment

According to the Commission, Cyprus' robust economic recovery can help accelerate the correction of excessive macroeconomic imbalances and provides a window of opportunity to implement growthenhancing reforms. Macroeconomic imbalances are declining but remain significant in several areas. These include high levels of public, private and external debt, a large negative net international investment position and a high stock of nonperforming loans. Unemployment is also declining but remains high, in a context of weak potential growth. Amid positive macroeconomic developments, a renewed reform momentum in key areas – e.g. the insolvency and foreclosure frameworks, the judicial system, the business environment, the public sector, education and the labour market – could help improve potential growth, reduce vulnerabilities and the risk of a slowdown, should the external environment and financial conditions become less supportive

In April 2018, Cyprus submitted its 2018 National Reform Programme and its 2018 Stability Programme.

The Country report, the National Reform Programme and the Stability programme (together with its assessment by the Commission), constituted the basis for the five CSRs adopted by the Council in July 2018. All the following CSRs addressed to Cyprus are underpinned by MIP:

1. Adopt key legislative reforms to improve efficiency in the ***public sector****, in particular as regards the functioning of the public administration and the governance of State-owned entities and local governments.*

2. Step up efforts to improve the ***efficiency of the judicial system*** *by revising civil procedures, increasing the specialisation of courts and setting up a fully operational e-justice system. Take measures to fully operationalise the insolvency and foreclosure frameworks and ensure reliable and swift systems for the issuance of title deeds and the transfer of immovable property rights.*

3. Accelerate the reduction of ***non-performing loans*** *by implementing a comprehensive strategy, including legislative amendments allowing for the effective enforcement of claims and facilitating the sale of loans. Integrate and strengthen the* ***supervision of insurance companies and pension funds****.*

4. Prioritise the implementation of key elements of the action plan for growth, in particular fast-tracking ***strategic investments****, and take additional measures to improve* ***access to finance*** *for small and medium-sized enterprises. Improve the performance of* ***State-owned enterprises*** *including by resuming the implementation of* ***privatisation*** *projects.*

5. Complete reforms aimed at increasing the capacity and effectiveness of the ***public employment services*** *and reinforce outreach and activation support for young people who are not in employment education or training. Complete the* ***reform of the education and training system****, including teacher evaluation and actions to increase the capacity of vocational education and training. Take measures to ensure that the* ***National Health System*** *becomes fully functional in 2020, as planned.*

Contact: egov@ep.europa.eu

This document is available on the Internet at: www.europarl.europa.eu/supporting-analyses

Annex 1: 2018 MIP scoreboard (2016 Data)

Year 2016	External imbalances and competitiveness					Internal imbalances						Employment Indicators		
	Current Account Balance % of GDP 3 year average	**Net International Investment Position** % of GDP	**Real Effective Exchange Rate with HICP deflator** 3 year % change	**Export Market Shares** 5 year % change	**Nominal ULC (2010=100)** 3 year % change	**House Prices index deflated** 1 year % change	**Private Sector Credit Flow** % of GDP	**Private Sector Debt,** consolidated % of GDP	**General Government Gross Debt** % of GDP	**Unemployment rate** 3 year average	**Total Financial Sector Liabilities, non-consolidated** 1 year % change	**Activity rate** % of total pop. aged 15-64 3 year change	**Long term unemployment rate** % of active pop. aged 15-74 3 year change	**Youth unemployment rate** % of active pop. aged 15-24 3 year change
Thresholds	**-4/+6%**	**-35%**	**±5% (EA) ±11% (non-EA)**	**-6%**	**+9% (EA) 12% (non-EA)**	**+6%**	**14%**	**133%**	**60%**	**10%**	**16.5%**	**-0.2 pp**	**0.5 pp**	**2 pp**
BE	-0.3	51.2	-0.4	-2.3	-0.6	1.0	13.3	190.1	105.7	8.3	1.2	0.1	0.1	-3.6
BG	1.8	-47.0	-4.7	8.2	9.5	7.1	4.0	104.9	29.0	9.4	11.1	0.3	-2.9	-11.2
CZ	0.5	-24.6	-3.7	2.9	2.9	6.7	4.4	68.7	36.8	5.1	14.5	2.1	-1.3	-8.4
DK	8.4	54.8	-1.5	-4.2	3.4	4.2	-10.4	210.7	37.7	6.3	3.3	1.9	-0.4	-1.0
DE	8.1	54.4	-2.6	2.8	5.2	5.4	3.8	99.3	68.1	4.6	5.2	0.3	-0.6	-0.7
EE	1.4	-37.1	4.5	-0.7	13.4	3.8	5.9	115.4	9.4	6.8	7.2	2.4	-1.7	-5.3
IE	5.5	-176.2	-6.6	59.8	-20.5	6.6	-19.0	278.1	72.8	9.5	2.5	0.7	-3.6	-9.6
EL	-1.0	-139.4	-3.9	-19.0	-3.3	-2.0	-1.7	124.7	180.8	25.0	-16.6	0.7	-1.5	-11.0
ES	1.4	-83.9	-4.3	2.2	0.4	4.7	-1.0	146.7	99.0	22.1	0.9	-0.1	-3.5	-11.1
FR	-0.7	-15.7	-3.1	-2.4	1.4	1.0	6.2	146.9	96.5	10.3	4.3	0.7	0.2	-0.3
HR	2.9	-70.1	0.1	8.1	-5.9	2.1	-0.1	106.1	82.9	15.6	2.5	1.9	-4.4	-18.1
IT	2.1	-9.8	-3.4	-2.8	1.9	-0.8	0.6	113.6	132.0	12.1	3.2	1.5	-0.2	-2.2
CY	-3.6	-127.8	-6.5	-3.0	-6.2	1.6	10.2	344.6	107.1	14.7	0.7	-0.2	-0.3	-9.8
LV	-0.3	-58.9	4.9	9.3	16.5	7.4	0.3	88.3	40.6	10.1	5.8	2.3	-1.7	-5.9
LT	-0.3	-43.2	5.4	5.4	14.7	4.5	4.3	56.2	40.1	9.2	16.3	3.1	-2.1	-7.4
LU	5.0	34.7	-1.5	26.2	2.5	5.9	1.5	343.6	20.8	6.3	7.5	0.1	0.4	2.2
HU	3.6	-65.0	-5.0	-0.4	3.3	13.6	-3.6	77.0	73.9	6.5	19.5	5.4	-2.5	-13.7
MT	6.7	47.6	-2.5	8.7	-0.1	4.8	11.1	128.4	57.6	5.3	1.7	4.1	-1.0	-2.0
NL	8.8	69.1	-2.3	0.1	-1.1	4.4	1.5	221.5	61.8	6.8	5.3	0.3	0.0	-2.4
AT	2.2	5.6	1.0	-4.0	5.8	7.2	3.2	124.0	83.6	5.8	-2.4	0.7	0.6	1.5
PL	-1.0	-60.7	-5.0	18.1	2.1	2.5	4.7	81.6	54.1	7.6	8.9	1.8	-2.2	-9.6
PT	0.3	-104.7	-1.9	5.8	0.9	6.1	-2.2	171.4	130.1	12.6	-0.2	0.7	-3.1	-9.9
RO	-1.3	-49.9	-2.5	23.6	6.0	6.5	0.6	55.8	37.6	6.5	7.6	0.7	-0.2	-3.1
SI	5.1	-36.9	-0.5	4.0	0.7	3.6	-0.8	80.5	78.5	8.9	3.2	1.1	-0.9	-6.4
SK	-0.7	-62.4	-1.6	7.3	3.5	7.0	9.2	94.7	51.8	11.5	8.5	2.0	-4.2	-11.5
FI	-1.2	-2.3	0.5	-14.1	2.1	-0.3	2.2	149.3	63.1	9.0	4.5	0.7	0.6	0.2
SE	4.6	11.2	-9.2	-7.9	2.0	7.6	7.6	188.5	42.2	7.4	9.0	1.0	-0.1	-4.7
UK	-5.5	-1.1	0.2	-0.1	3.1	5.5	8.2	168.1	88.3	5.4	11.6	0.9	-1.4	-7.7

Source: 2018 AMR. Boxes shaded in grey indicate values outside the threshold. For updated figures, see Eurostat dedicated webpage