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IN-DEPTH ANALYSIS

Economic Dialogue with the President of the Eurogroup and the President of ECOFIN Council

ECON on 18 February 2016

Mr. Jeroen Dijsselbloem has been invited to a regular Economic Dialogue, in particular, in accordance with Article 2ab of Regulation 1466/97 as amended, in his capacity of both the President of the Eurogroup and the President of ECOFIN (January – June 2016). This briefing gives on overview of the ongoing work of the Eurogroup/Council as regards public finances, macro-economic imbalances and the banking union. Mr Dijsselbloem has been the Eurogroup President since 21 January 2013. As the President of the Eurogroup, he is also chairing the Board of Governors of the ESM.

1. Latest economic developments

Euro area recovery has somewhat lost momentum in the second half of 2015[1]. According to Eurostat's first estimate, euro area real GDP expanded by 0.3% (q-o-q) in Q4 2015, after respectively 0.3% 0.4% and 0.5% (q-o-q) in the three previous quarters. If confirmed, this would bring the euro area annual GDP growth to 1.5% for 2015, a notch below the latest Commission (COM) projection of 1.6% in its Winter 2016 forecast (see Table 1 below). Private consumption, supported by low energy prices[2], has been the main driver of growth. At the same time, the ECB's monetary policy stimulus has helped to maintain the euro weak, providing a boost to exporters and contributing to a large euro area's current account surplus. As such, no Member States is expected to record a contraction in output during 2015 for the first time since the start of the crisis, though growth differences across countries are persisting. Looking ahead, the COM expects the euro area economy to continue to recover at a moderate pace. However, this recovery is *"slow, both in historical perspective and compared to other advanced economies"*, the COM said.

Table 1: Comparison of the Commission's forecasts for selected macroeconomic variables

	COM forecast	2015	2016	2017
	Real GDP growth			
Euro area	Winter 2016	1.6	1.7	1.9
	Autumn 2015	1.6	1.8	1.9
EU28	Winter 2016	1.9	1.9	2.0
	Autumn 2015	1.9	2.0	2.1
	HICP Inflation			
Euro area	Winter 2016	0.0	0.5	1.5
	Autumn 2015	0.1	1.0	1.6
EU28	Winter 2016	0.0	0.5	1.6
	Autumn 2015	0.0	1.1	1.6
	Unemployment			
Euro area	Winter 2016	11.0	10.5	10.2
	Autumn 2015	11.0	10.6	10.3
EU28	Winter 2016	9.5	9.0	8.7
	Autumn 2015	9.5	9.2	8.9

Source: European Commission (Winter 2016 and Autumn 2015 forecasts).

[1] See Annex 1 for an overview table of the main euro area economic indicators.
[2] Declines in energy prices acts on private consumption in a similar manner as a tax cut.

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The EU28 is expected to growth at a somewhat higher pace than the euro area, with the growth differential narrowing over the forecast horizon. Finally, compared to the previous round of projections, the COM revised in the Winter 2016 forecast its growth projections marginally downwards (for 2016 in the case of the euro area and for both 2016 and 2017 in the case of the EU28).

The COM sees the **balance of risks surrounding the growth outlook on the downside**, reflecting predominantly stronger-than-expected and more rapid slowdown in China and other emerging economies, possible financial stability risks stemming from the US monetary policy normalisation impact on emerging market economies with high level of foreign-currency denominated debts and political challenges within the EU itself (including refugee crisis or any unexpected relapse into crisis in Greece).

Annual headline HICP inflation has remained on a downward trend since 2012 and fell to 0.0% in 2015 in both the euro area and the EU28. As regards the euro area, this persistent weakness reflects, according to the COM, negative output gap, subdued wage developments and lower commodity prices. Core inflation (HICP excluding energy and unprocessed food) has also remained below expectations. While inflation is still projected to pick up in line with strengthening domestic demand, it is to accelerate at a much smaller pace during 2016 than expected three months ago.

After peaking in 2013, the unemployment rate has continued to decline in both the euro area and the EU28 to stand, taking into account the latest monthly Eurostat data[3], at 10.5% and 9.4% respectively in 2015. These aggregate figures mask large differences across Member States: at the low end of the spectrum, the unemployment rate stood at 4.6% in Germany and 5.1% in the Czech Republic, while on the other side, 22.1% and 25.1%[4] of the workforce was unemployed in Spain and Greece respectively. Looking ahead, the COM sees unemployment to further decline over the forecast horizon in line with moderate recovery in both the euro area and the EU28.

Box 1: Eurogroup work programme for the first half of 2016

On 7 December 2015, the Eurogroup issued its indicative work programme for the first half of 2016. The agenda is mainly devoted to coordinating policy responses to bolster economic growth and job creation in the euro area. The Eurogroup will also:

- Contribute to strengthening the prominence and implementation of the European Semester;
- Continue to review macro-financial assistance programmes (EL, CY) and exert the related post-programme surveillance (IE, PT, ES);
- Monitor the implementation of the EDP recommendations to euro area Member States;
- Held discussions on the euro area fiscal stance and fiscal policy in a low interest rate environment, if warranted;
- Closely scrutinize financial and macroeconomic stability developments within the euro area, with specific attention devoted to Member States with excessive macroeconomic imbalances and Member States with imbalances requiring decisive policy action;
- Help to further develop the Banking Union, including better understanding and minimising risks within the Banking Union and working towards a level playing field;
- Prepare Euro Summit meetings, in particular providing input to discussions on deepening of the EMU;
- Aim at fostering consensus on the issue of external representation of the euro area.

[3] In December 2015, the unemployment rate came in at 10.4% in the euro area and 9.0% in the EU28. These are the lowest observed rates since November 2012 and July 2009 respectively. The euro area (the EU28) youth unemployment came in at 22.0% (19.7%) during the last month of 2015, as compared to a record high of 24.6% (24.0%) at the beginning of 2013.

[4] This figure corresponds to the average unemployment rate over the first ten months of 2015 (the November and December data not being available as yet).

Box 2: Recent Eurogroup statement on transparency

On 11 February 2016, Ministers discussed possible ways to increase transparency of Eurogroup meetings "*to answer to public interest and to bring more consistency to the level of information that reaches our citizens and our parliaments in different member states*". Mr Dijsselbloem considered this issue to be of prime importance for the legitimacy of the Eurogroup's work.

In substance, the Eurogroup agreed that more consistency is needed in the way citizens and national parliaments in the Member States are informed of its activities.

As a first step, the annotated agendas and the summaries of the Eurogroup discussions will be made public. There is also *"general support in principle to publish documents as much as possible"*. The EWG has been asked to further fine-tune the practical implementation of these proposals.

Box 3: Priorities of the Netherlands Presidency

In the programme for its Presidency of the Council of the European Union, the Netherlands outlined the following four priorities: (1) a comprehensive approach to migration and international security; (2) Europe as an innovator and job creator; (3) sound, future-proof European finances and a robust eurozone and finally (4) forward-looking policy on climate and energy.

As regards *Economic and financial affairs* in particular, the Netherlands Presidency will aim at:

- Creating optimal conditions for lasting economic growth and prosperity in the Union via best possible use of the current EMU framework, with particular emphasis on reforms and fiscal consolidation and deepening the Single market;
- Further strengthening and streamlining the European Semester so as to strengthen implementation of the country specific recommendations and promote structural reforms and better governance in the Member States;
- Holding discussions on the issue of the EMU's external representation;
- Seeking improvements to the functioning of the SGP - the Netherlands Presidency supports steps towards a simpler and more transparent SGP;
- Taking forward the process of the completion of the Banking Union (BU), by ensuring that the extra measures required to complete the BU are developed further;
- Completing the COM Action Plan of Building a Capital Markets Union (which includes two regulations on securitisation);
- Starting and taking forward trialogues on bank structural reform (as soon as the European Parliament has determined its position).

2. Public Finances

In the area of public finances, the 2016 Country Specific Recommendations for the euro area as a whole (see Annex 3) include (1) the coordination of fiscal policies to ensure that the aggregate euro area fiscal stance is in line with sustainability risks and cyclical conditions; (2) the conduction of thematic discussions by spring 2016 on improvements in the quality and sustainability of public finances, in particular on the prioritisation of investment, and on making tax systems more growth friendly; (3) monitor the effective functioning of the recently strengthened national fiscal frameworks.

According to the COM Winter 2016 forecast, the **aggregated budget deficit is expected to continue declining** over the forecast horizon in the euro area (from 2.2% of GDP in 2015 to 1.9% in 2016 and 1.6% in 2017) and in the EU (from 2.5% in 2015 to 2.2% in 2016 and 1.8% in 2017), albeit at a slower pace than in recent years due to the fiscal expenditures associated with the arrival of asylum-seekers in a few countries and to fiscal policy measures adopted by some Member States to lower the tax wedge on labour. The operation of automatic stabilisers and, to a lesser extent, the lower interest expenditure, underpins the projected deficit reduction. The COM estimates for the euro area that the structural balance remained broadly stable in 2015, while the fiscal stance is expected to be slightly expansionary in 2016. In 2017, the structural balance is projected to remain broadly stable in both the euro area and the EU. Public debt in the euro area is forecast to decline

from its peak of 94.5% of GDP in 2014 to 91.3% of GDP in 2017; a similar development is projected for the EU (88.6% in 2014, the year of the peak, to 85.7% in 2017)

The COM concluded on the basis of its 2015 autumn assessment of the Draft Budgetary Plans (DBPs) that the 2016 DBPs of **four euro area Member States (IT, LT, AT and ES) have a risk of non-compliance** with the rules of the SGP. In all cases, COM will examine the situation further on the basis of the data validated by Eurostat in April 2016, which could lead to new Council-decisions either under the preventive or corrective arm of the SGP.

The recently elected **Portuguese government submitted its DBP** to the COM on 22 January 2016. The PT authorities announced additional consolidation measures on 5 February 2016. In its assessment of 5 February 2016, the COM considered that while the government no longer plans a significant deviation from the recommended structural adjustment, its revised DBP still remain at risk of non-compliance with the provisions of the SGP. The Eurogroup of 11 February 2016 took note that, according to the COM Opinion, *"the planned structural fiscal effort in 2016, taking into account the measures announced, is between 0.1 and 0.2% of GDP, which implies a difference below 0.5% of GDP with respect to the 0.6% of GDP required to fully comply with the Council recommendation of 14 July 2015"*. It acknowledged that the DBP was not found to be in particularly serious non-compliance with the obligations of the SGP. The Eurogroup agreed with the COM assessment that, even taking into account those additional measures, the budget remains at risk of non-compliance with the requirements of the SGP. It also noted that the macroeconomic scenario for 2016 in the DBP is more optimistic than the COM Winter 2016 forecast. In this context, the Eurogroup welcomed the commitments of the PT authorities to prepare, as of now, additional measures to be implemented when needed to ensure that the 2016 budget will be compliant with the SGP.

Box 4: Independent fiscal institutions

Legal background: In accordance with EU Regulation 473/2013, euro area Member States should have in place independent bodies which produce or endorse national medium-term fiscal plans and draft budgets as well as their underpinning macroeconomic forecasts. According to the same Regulation, the independent bodies shall be endowed with functional autonomy vis-à-vis the budgetary authorities of a Member State. Furthermore, the provisions to have such independent bodies are applicable to all EU Member States (except the UK) in accordance with Council Directive 2011/85/EU.

Implementation: There is no updated overview on mandate, resources and independence of independent fiscal institutions in the EU. The available information is the following:

- EGOV published in February 2016 an overview on the involvement of independent fiscal bodies in 2016 DBPs and 2014/2015 Stability and Convergence Programmes, as reported by Member States;
- The last update of a COM database includes some information on the role and mandate of the independent fiscal institutions, but its content relates to 2013;
- The network of EU Independent Fiscal Institutions (IFI), while not publishing updated information on IFIs' mandate and resources, issued a position paper last 15th November 2015 on "Initiatives to strengthen the EU fiscal framework". With an aim at contributing to the reinforcement of the EU fiscal framework, while strengthening its ownership at national level, the paper puts forward three proposals: 1) cooperate with the recently created European Fiscal Board (EFB) in order to develop a set of minimum standards IFIs should comply with, ensuring that they have an adequate remit, a commensurate level of resources, good and timely access to information and a reinforced position through comply-or-explain procedures; 2) cooperate with the COM and the EFB in the preparatory work on streamlining the fiscal rules; 3) provide inputs as regards the enforcement and implementation of existing legislation on national fiscal frameworks;
- A first case of an IFI defending its independent status and correct functioning is represented by the Spanish IFI. On 4 November 2015, the *Autoridad Independiente de Responsabilidad Fiscal* (AIReF) took the Spanish Ministry of Finance to Court in order to defend its direct access to relevant data.

Table 2 below shows **changes in the structural balances as forecast by the COM and the structural efforts recommended by the Council under the SGP**. While this comparison indicates that only Germany, Ireland, Luxembourg, the Czech Republic, Sweden and the UK are in line with the recommended effort, it does not mean that the other countries are breaching the SGP recommendations, since the latter may include other aspects than the change in the structural balance (e.g. meeting nominal targets, prevalence of a period to correct an EDP and not only individual years, bottom-up assessments of individual measures and careful analyses).

Table 2: Structural efforts and commitments under the SGP in 2015 and 2016

Member State	Projected structural budget balance (sbb) or projected annual structural budget change (pp)		Structural effort recommended in order to adjust towards or remain at the MTO (for MS under the preventive arm) or to correct excessive deficit (for MS under EDP) (based on Council decision under the SGP)	
	2015	2016	2015	2016
Euro area Member States				
Belgium *(preventive arm)*	0.2 pp	0.3 pp	0.6 pp	0.6 pp
Germany *(preventive arm)*	0.8 sbb	0.3 sbb	Remain/attain MTO set at -0.5 sbb	
Estonia *(preventive arm)*	0.5 sbb	0.3 sbb	Remain/attain MTO set at 0.0 sbb	
Ireland *(corrective arm, EDP ddl 2015)*	0.5 pp	0.7 pp	n.a.	0.6 pp
Greece *(corrective arm)*	-1.9 pp	0.5 pp	At least 10.0pp (cumulative) in 2009-14	
Spain *(corrective arm)*	-0.8 pp	-0.1 pp	0.8 pp	1.2 pp
France *(corrective arm)*	0.2 pp	0.4 pp	0.5 pp	0.8 pp
Italy *(preventive arm)*	0.1 pp	-0.7 pp	0.25 pp	0.1 pp
Cyprus *(corrective arm)*	-1.9 pp	0.3 pp	More than 4.0 pp (annual over) in 2013-16	
Latvia *(preventive arm)*	-1.9 sbb	-1.7 sbb	Ensure limited deviation from MTO set at -1.0sbb	
Lithuania *(preventive arm)*	-1.1 sbb	-1.5 sbb	Ensure limited deviation from MTO set at -1.0sbb	
Luxembourg *(preventive arm)*	0.8 sbb	0.9 sbb	Remain/attain MTO set at 0.5sbb	
Malta *(preventive arm)*	0.3 pp	0.6 pp	0.6 pp	0.6 pp
Netherlands *(preventive arm)*	-1.2 sbb	-1.7 sbb	Remain/attain MTO set at -0.5 sbb	
Austria *(preventive arm)*	-0.3sbb	-1.0 sbb	Remain/attain MTO set at -0.45 sbb	
Portugal *(corrective arm, EDP ddl 2015)*	-0.5 pp	-1.0 pp	0.5 pp	0.6 pp
Slovenia *(corrective arm, EDP ddl 2015)*	0.2 pp	0.1 pp	0.5 pp	0.6 pp
Slovakia *(preventive arm)*	-2.1 sbb	-1.8 sbb	Remain/attain MTO set at -0.5 sbb	
Finland *(preventive arm)*	0.1 pp	0.0 pp	0.1 pp	0.5 pp
Non-euro area Member States				
Bulgaria *(preventive arm)*	0.2 pp	-0.5 pp	n.a.	0.5 pp
Czech Republic *(preventive arm)*	-0.8 pp	1.3 pp	n.a.	0.5 pp
Denmark *(preventive arm)*	-1.7 sbb	-1.4 sbb	Remain/attain MTO set at -0.5 sbb	
Croatia *(corrective arm)*	0.8 pp	-0.5 pp	0.9 pp	0.7 pp
Hungary *(preventive arm)*	0.3 pp	-0.3 pp	0.5 pp	0.6 pp
Poland *(preventive arm)*	-0.1 pp	-0.5 pp	0.5 pp	0.5 pp
Romania *(preventive arm)*	-1.0 sbb	-3.0 sbb	Ensure limited deviation from MTO set at -1.0sbb	
Sweden *(preventive arm)*	-0.7 sbb	-1.0 sbb	Remain/attain MTO set at -1.0 sbb	
United Kingdom *(corrective arm)*	0.8 pp	1.1 pp	0.5 pp (2015/16)	1.1 pp (2016/17)

Sources: Council recommendations under the SGP (see EGOV documents "Country Specific Recommendations (CSRs) for 2014 and 2015" and "Implementation of the SGP and COM Opinions on 2016 DBPs") and COM 2015 winter forecast. Please note that the assessment on effective action follows a EU methodology which takes into account more aspects than the change in the structural balance and covers the whole period of the Council decision to correct the excessive deficit and not only individual years (see "Public Finances in EMU"). Abbreviations used in the table: pp indicates annual percentage point change in terms of GDP; sbb indicates annual budget balance in structural terms; ddl indicates dead-line to correct on-going EDP; and n.a. indicates that an explicit structural target for a given year is not available in the relevant Council recommendations.

The COM Fiscal Sustainability report 2015, published in January 2016, concludes that 11 Member States have an **overall high medium-term fiscal sustainability risk** (and debt sustainability risk). It also shows that five Member States have a medium medium-term risk. Furthermore, one country has a high and 14 countries have a medium long-term fiscal sustainability risk. The country-specific

results are shown in Annex 4. For further information on the implementation of the SGP in the euro area and non-euro area Member States, please see separate EGOV note.

Box 5: The ECB's view on the lack of transparency in the SGP implementation

According to the ECB, the review of the 2016 DBPs revealed again the increased complexity and lack of transparency of the implementation of the fiscal surveillance framework:

- The manner in which this overall assessment of structural balance and the expenditure benchmark indicators still not fully transparent, making it difficult to gauge whether it is applied in a consistent manner;
- Increasing inconsistencies between the structural effort requirements under the preventive arm and those under the debt rule for several countries, with COM forecast indicating significant deviations from the debt rule requirements for BE and IT;
- For countries under the excessive deficit procedure, an asymmetry arises from them being assessed as "broadly compliant" with the SGP if they fall short of their structural effort requirements but are nonetheless expected to meet the headline deficit targets.

3. Macro-economic imbalances

In the area of macro-economic imbalances, the 2016 Country Specific Recommendations (Annex 3) include: policies that support the recovery, foster convergence, facilitate the correction of macroeconomic imbalances and improve adjustment capacity. To this end, Member States, particularly those with large stocks of private and foreign debt, should implement reforms that enhance productivity, foster job creation, raise competitiveness and improve the business environment. Member States with large current account surpluses should implement as a priority measures, including structural reforms, that help strengthen their domestic demand and growth potential.

In November 2015, the COM published the 2016 Alert Mechanism Report, launching the **fifth surveillance cycle in the context of the Macroeconomic Imbalance Procedure** (MIP), aimed at preventing and correcting macroeconomic imbalances in EU Member States. The report identifies, on the basis of the MIP scoreboard, the 18 countries for which the COM undertakes further in-depth-review (the current status of MIP implementation is presented in a separate EGOV note). In late February 2016, the COM will publish the country specific reviews in order to conclude whether imbalances or excessive imbalances exist. Based on this assessment the COM may propose opening the Excessive Imbalance Procedures (it would be the first time).

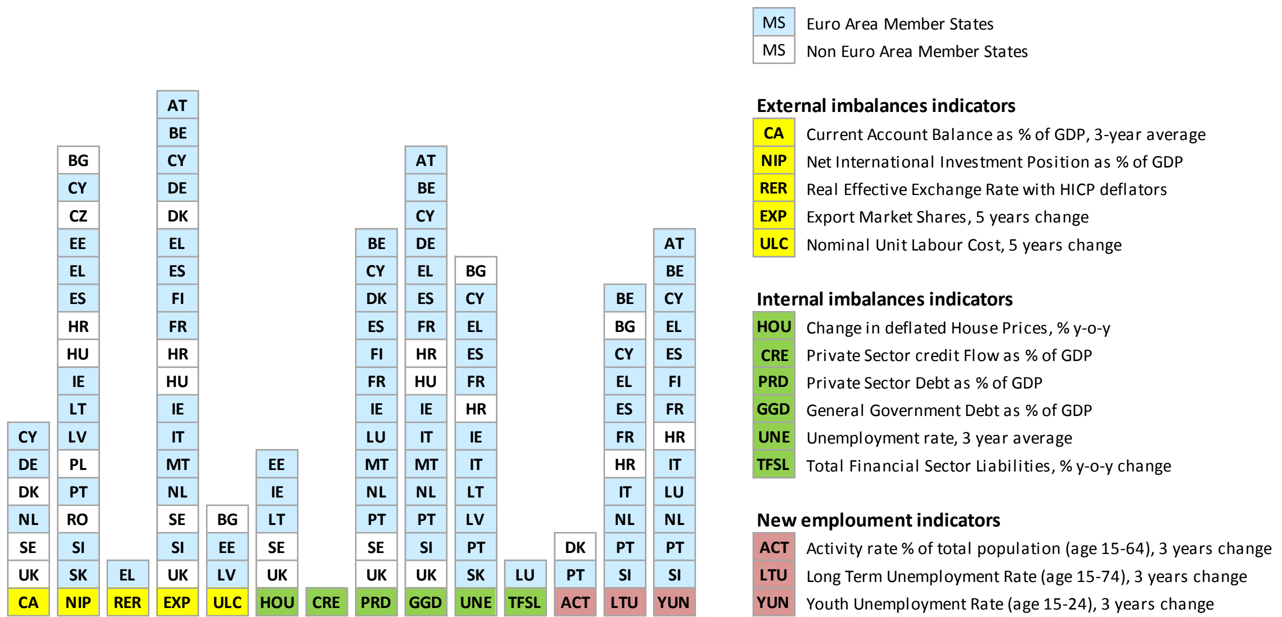
This year **three "labour market indicators**" - namely activity rate, long-term and youth unemployment - have been added to the main scoreboard, on the argument that long, protracted negative employment and social developments can have a negative impact on potential GDP and risk compounding macroeconomic imbalances. The Parliament has welcomed this change, and the Council has expressed a more reserved position on it (see Box 5 below).

Box 6: ECOFIN position on the 2016 AMR

On 16 January 2016, the ECOFIN Council:

- Agreed that *the MIP procedure should be used to its full potential, with* ***the corrective arm applied*** *where appropriate*
- Expressed ***concern about the inclusion of three additional employment indicators*** *to the main scoreboard, given the need to preserve the effectiveness of the scoreboard as an early warning device...* Underlined that *social and labour market indicators are not relevant for identifying macro-financial risks and developments in these indicators cannot trigger steps in the MIP process;*
- Invited *Member States to* ***address in an ambitious and concrete manner*** *the issues identified within the framework of the MIP.*

Figure 2: MIP 2016 scoreboard indicator - Member States with values beyond the thresholds



Source: EGOV based on Eurostat.

The figure above and the COM analysis show that:

- Some Member States present large and persistent **current account surplus** (for DE and NL they may have potential relevance for the rest of euro area);
- Or some countries (IT, FR and BE) the **high public debt** is combined with a declining trend in potential growth;
- In several Member States (PT, ES, CY, IE and SI), the **stock of liabilities**, private and public, external and internal, are at very high levels and require deleveraging in a context of limited fiscal space. Also some non-Euro Area countries (HU, HR and BG) are facing difficulties in light of high external and internal liabilities (especially in the banking sector);
- Many Member States, especially in the Euro Area, are experiencing a decrease of **export shares**, sign of loss in competitiveness;
- Many Member States (RO, PO, LV, LT, SK and CZ) present vulnerabilities related to the **net international investment position**, due to their status of catching-up economies;
- Labour market conditions are converging, but indicators of the **employment situation** show unacceptable conditions in many countries, mainly in those concerned by macroeconomic imbalances and debt crises;
- Possible **unsustainable trends and vulnerabilities can be observed in particular aspects of the economy** (in SE the increase in house prices and household debt; in NL household are deleveraging on the high debt; UK is experiencing growing house prices; AT presents vulnerabilities in the financial sector; EE has risks linked to the build-up of internal demand; FI experiences challenging structural shift in its economy, following the downsizing of the electronics sector; DK, LU and MT also have elevated household debt).

Box 7: The Euro Area dimension of macroeconomic imbalances and recommendations

In line with the COM Communication "On steps towards completing Economic and Monetary Union", the 2016 AMR provides a more systematic analysis of the **euro-area implications** of countries' imbalances and how such implications require coordinated policy responses.

At the aggregate level, the **euro area is posting a current account surplus**, which is one of the largest in the world and is expected to rise again this year. Such surplus largely reflects an excess of domestic savings over investment. Simultaneously, **deleveraging pressures** can be observed in all sectors of the economy (households, corporation and government), even if there are disparities across Member States.

On the basis of the analysis presented in the AMR and in the COM Report on the Euro Area, the COM proposed the Council Recommendation on the economic policy of the euro area (see Annex 3). According to the COM, cross-border spillovers within the euro area require a **coordinated approach** to macroeconomic imbalances, while supporting the recovery. More specifically:

- Euro area Member States should pursue policies that support the recovery, foster convergence, facilitate the correction of macroeconomic imbalances and improve adjustment capacities. Countries with fiscal spaces should boost domestic demand and investments. Meanwhile, structural reforms should be stepped up, in particular in countries of systemic relevance like Italy and France. Countries where demand is limited by high debt and non-performing loans, should focus on growth enhancing reforms, with specific reference to actions and effective implementation in the fields of competitiveness and insolvency;
- Reforms should combine improvements in the labour market and social protection systems, as well as open and competitive product and services markets; the tax wedge on labour should be reduced.

4. Banking Union

The Work programme for the Eurogroup for the first half of 2016 provides that "*The Banking Union should be further developed. We also need to better understand and minimise risks within the Banking Union and work towards a true level playing field*".

4.1 Completing the Banking Union

The building-up of the **institutional architecture of the Banking Union** is well in train: the Single Supervisory Mechanism (SSM) is fully operational since November 2014 under the aegis of the ECB, and the Single Resolution Board is in charge of the resolution of significant and cross-border banks since January 2016. The bail-in of subordinated creditors, as required under State aid rules, was enforced by the COM in 2015, paving the way for the full application of the new rules as from 1 January 2016. As of 5 February 2016:

- 20 Member States, including all of the current 19 members of the banking union, had deposited their instruments of ratification of an intergovernmental agreement IGA on the SRF;
- three of the 19 Member States of the banking union had signed a loan facility agreement on bridge financing for the SRF;
- 24 of the 28 Member States had fully transposed the bank recovery and resolution directive, whilst the four others had partially transposed it;
- 21 of the 28 Member States had fully transposed the directive on deposit guarantee schemes.

However, the President of the Eurogroup indicated that **the Banking Union was not complete yet** and that more was needed to protect depositors, strengthen investment and facilitate SMEs' access to credit. The Five Presidents report also highlighted the need to establish a true financial union, in order to diversify risk across countries and absorb asymmetric shocks with a lesser reliance on fiscal resources.

On 24 November 2015, the COM published a Communication *'Towards the completion of the Banking Union'* describing its vision of what the next steps of the Banking Union should be. The

Communication accompanies the legislative proposal on **a European Deposit Insurance Scheme (EDIS)**: *'This Communication places the proposal [to establish EDIS] in the broader context of completing the Banking Union and the necessary additional measures of risk sharing and risk reduction in the banking sector'.*

Ten risk reduction measures -presented as counterbalancing measures to further risk sharing as a consequence of EDIS- are listed (See PE 574.392 '*Completing the Banking Union*'):

1) Reduction of national options and discretions;
2) Review of the macro-prudential policy framework;
3) Harmonisation of national deposit guarantee schemes;
4) Review of the minimum requirement for own funds and eligible liabilities -MREL-;
5) Operationalizing the Single Resolution Fund;
6) Consistent application of bail-in rules;
7) Convergence of national insolvency laws;
8) Reducing the level of non-performing loans in banks' balance sheet;
9) Prudential measures on leverage, stable funding, comparability of risk-weighted assets;
10) Treatment of sovereign risk.

The European Parliament has appointed its rapporteur (MEP E. de Lange, EPP) and shadow rapporteurs on the EDIS file and the Council has set up an ad hoc Working Group to deal with the COM proposal.

4.2 Tackling the sovereign-bank nexus

The financial and sovereign debt crisis has shown the need to address **the 'sovereign-bank' nexus**, namely the link between banks and their home country which often results from the banks' exposure to their sovereign through bonds, loans or tax assets. Conversely, distressed banks may also negatively impact the financial position of a sovereign through various channels.

The European Political Strategy Center[5], while acknowledging that several options are available to tackle the concentration of government debt in the banking system, recommended implementing **concentration limits**, which would cap a bank's holdings of its national government's debt as a proportion of total assets or of total capital. The President of the Eurogroup recently indicated that such limits may indeed be required.

Table 3: Average exposures to the Home sovereign and holdings of Home sovereign bonds

Country	AT	BE	CY	DE	DK	ES	FI
EBA sample size	5	5	3	20	4	14	1
Exposure to Home sovereign[1]	5,5%	7,3%	6,5%	7,6%	1,3%	7,5%	0,8%
Home sovereign bonds[2]	2,8%	3,2%	2,5%	3,3%	0,3%	2,7%	0,0%
Country	FR	HU	IE	IT	LU	LV	MT
EBA sample size	10	1	3	14	2	1	1
Exposure to Home sovereign[1]	4,2%	13,5%	6,8%	10,1%	4,7%	4,5%	8,5%
Home sovereign bonds[2]	1,5%	12,8%	4,3%	6,7%	2,7%	4,4%	7,5%
Country	NL	NO	PL	PT	SE	SI	UK
EBA sample size	6	1	1	3	4	2	4
Exposure to Home sovereign[1]	3,6%	1,2%	13,7%	7,5%	1,2%	10,0%	2,7%
Home sovereign bonds[2]	1,4%	0,1%	8,5%	4,2%	0,5%	8,0%	2,3%

Source: EGOV calculations based on data from the EBA 2015 Transparency exercise.

Notes: [1] Net Direct Position of sovereign debt at country level (weighted according to the size of each bank in the country sample; reference date 30 June 2015), as % of total assets;

[2] Corrected for Loans and Advances as shown by EBA, and Current Tax Assets and Deferred Tax Assets as shown in the banks' financial statements according to the Bankscope® database, if available.

[5] The European Political Strategy Centre (EPSC) operates under the direct authority of the President of the Commission. Its mission is to provide professional and targeted policy advice to the President and the College.

A recent publication by the European Banking Authority (EBA), which presents the outcome of its 2015 **EU-wide transparency exercise** (the sample comprises 105 significant banks from 21 countries[6] of the European Economic Area, covering more than two thirds of total EU banking assets), shows that in some countries banks still have strong links to the Home sovereign (see Table 3 and separate EGOV note on *'Banks' Home sovereign exposures'*). The data furthermore indicates that while Home sovereign bonds are an important subset of banks' Home sovereign exposures, they are not the only significant source for financial relationships; loans and tax assets have to be taken into account as well (the average holdings of Home sovereign bonds are based on EGOV calculation).

4.3 The challenge of NPLs in the EU

The CSR 4 for the euro area provides that the euro area shall 'facilitate the gradual reduction of banks' non-performing loans and improve insolvency proceedings for businesses and households'.

Table 4: Evolution of NPL ratio in the EU Member States

NPL ratio (%)	Dec-08	Dec-11	Dec-13	Jun-15
Austria	1.95	4.05	4.23	6.03
Belgium	3.94	4.18	5.27	3.08
Bulgaria	4.77	19.66	18.59	
Croatia			11.79	13.17
Cyprus	4.18	11.89	37.06	35.29
Czech Republic				
Denmark	1.62	3.02	3.87	3.89
Estonia	2.33	4.52	1.89	2.41
Finland	0.84	0.80	0.67	1.28
France	3.11	4.63	4.64	3.65
Germany	1.89	1.61	1.81	2.26
Greece	3.12	12.10	24.19	32.92
Hungary	3.74	12.80	14.03	12.64
Ireland			18.38	14.58
Italy	4.97	9.47	12.92	16.08
Latvia	2.72	10.13	5.56	7.49
Lithuania	3.58	13.38	8.50	6.42
Luxembourg	0.20			1.12
Malta	1.26	1.55	2.01	3.56
Netherlands	1.87	2.42	2.73	2.56
Poland	3.38	6.02	5.98	5.24
Portugal	1.65	5.33	7.79	13.58
Romania	1.47	11.36	17.87	12.66
Slovakia	1.73	4.02	3.75	4.13
Slovenia			17.14	16.58
Spain	2.56	5.23	7.91	5.93
Sweden		0.56	0.47	1.02
United Kingdom	0.98	2.17	1.78	0.35
Euro area 19	**1.96**	**3.42**	**4.30**	**4.45**
EU28	**1.76**	**2.90**	**3.63**	**4.23**

Source: ECB.

As shown it Table 4, since the start of the crisis, the distribution of NPLs has been highly unequal among Member States, with crisis-hit countries suffering major increases in NPL ratios. At the end of June 2015, the two countries which had to implement strict capital controls, Greece and Cyprus, report NPL ratio of more than 30%. Croatia, Hungary, Ireland, Italy, Portugal, Romania and Slovenia all report gross NPL ratio between 10% and 20%. According to the ECB, among those countries, only 3 reported an increase in NPL ratio in the first half of 2015: Greece (+1.21 pp), Cyprus (+0.59 pp) and Italy (+0.17 pp). The (un-weighted) average of cumulative GDP growth

[6] BG, CZ, EE, EL, HR, LT, RO, and SK were not covered by the EBA 2015 Transparency exercise.

rates from 2007 to June 2015 is -1.7% for those 9 countries, while it stands at +8.7% for the euro area, which underlines the correlation between a weak economic environment and the deterioration of asset quality.

According to an IMF Staff Discussion Note published in September 2015, NPL constitute a drag on economic activity, especially for countries that rely mainly on bank financing, as is the case in the euro area. High NPL reduce profitability, increase funding costs and tie up bank capital, which negatively impact credit supply.

According to the IMF authors, different kinds of measures can help resolving the NPL issue. They are complementary as their simultaneous implementation ensures a stronger impact. Most of them were introduced in crisis-hit countries, in particular those which experienced financial assistance programmes such as Greece, Cyprus, Ireland, Spain, Portugal. However other countries with acute NPL problems have also implemented such reforms to various extents, as Slovenia and Italy. The list below provides some examples of the measures taken to date in each area:

A) Supervisory work on loss recognition and troubled assets management

Loss forbearance is a major obstacle to debt restructuring or asset sales. Supervisor can therefore take a tough stance and undertaken asset quality reviews to check the classification of loans and the level of provisioning. Such exercise was carried out by the ECB before taking over supervisory powers. In Greece, the supervisor also completed a thorough review of banks' practices regarding the management of NPL, which lead, inter alia, to the establishment of internal restructuring units in all large Greek banks.

B) Reform of insolvency frameworks

Insolvency frameworks are key for the efficient resolution of NPL, as they provide positive/negative incentives to all stakeholders. In particular, inefficient frameworks will make it difficult for debtors and creditors to agree on a timely restructuring of bad debts. The creation of out-of-court procedures and the acceleration of judicial procedures, by reducing the timeline for debt restructuring, also improve the value of NPL and reduce creditors' losses. Italy enacted such reforms in 2015 (see also Ireland and Spain in box 9).

C) Creation of bad banks or special purpose vehicles

In order to transfer NPL and thereby accelerate the cleaning of banks’ balance sheets, various countries decided to create asset management companies or special purpose vehicles, in particular Spain, Ireland, Slovenia, and, more recently, Hungary and Italy (see box 8). Such structures involve State aid if assets are transferred above market values. The main advantage is to free up capital and human resources within the bank, which can focus on its core business and new lending, while avoiding costly firesales in illiquid markets.

D) Developing the secondary market for NPL

The sale of NPL portfolios to investment funds requires a minimum level of liquidity in the market. This in turn will depend on the quality of the legal framework and on the adequacy of loan loss reserves in banks' balance sheets. An active secondary market for NPLs could attract NPL specialists able to restructure such portfolios and optimally relieve viable business from unsustainable debt levels. The legal impediments sometimes limit the development of such market, when, for example, strict conditions must be fulfilled by investors.

E) Amending tax rules

One other area of reform is the tax system, since full loan loss deductibility provides strong incentives for banks to adjust timely the book value of NPL. Indeed, if banks cannot deduct loan losses from their taxable income, they have no incentive to aggressively book loan losses reserves.

In 2012 Italy shortened the timeline for full loan loss deductibility from 18 years to 5 years, and then in 2015 from 5 year to immediate full deductibility.

Box 8: The recent impaired asset measure proposed in Italy to tackle NPL

On 26 January 2016 Italy and the COM agreed on the structure of an impaired asset measure aimed at tackling the rising amount of NPL in Italy. Italian banks would be allowed to transfer NPL to special purpose vehicles, so that those loans can be repackaged and sold to investors. The Italian government would provide a guarantee on the senior tranche of those securitization transactions, and charge guarantee fees on market terms, provided that senior tranche is awarded an investment-grade rating by an independent rating agency. Under the foreseen mechanism, the junior and mezzanine tranches shall not be repaid until the senior tranches guaranteed by the State have been fully repaid. The COM announced on 10 February 2016 that the transaction would not involve State aid.

According to the Italian Treasury, *"the existence of a State guarantee will facilitate funding of transfers of bad loans. This is an additional step in the series of measures taken in the last few months to help strengthening the banking sector (with the most important cooperative banks turned into joint stock companies, the reform of banking foundations, simplification of procedures for the credit recovery and shortening the duration of bankruptcy procedures, compliance with European standards on the tax treatment of loan write-downs, the forthcoming reform of cooperative banks)"*.

The Five Presidents Report identified that harmonising national insolvency laws would be necessary to ensure integration of capital markets. The Eurogroup conducted a thematic discussion and published a subsequent statement confirming that it is agreed that this issue is "*particularly relevant for the euro area, especially in addressing the debt overhang, and also because the euro area economies are prone to spill-over effects*". The Eurogroup agreed that **a set of common principles and benchmarks** would be useful to improve efficiency and effectiveness of those frameworks, and agreed to continue the discussion in spring 2016.

Box 9: National insolvency frameworks - the Irish and Spanish examples

Ireland

The EU/IMF Programme for Financial Support for Ireland included a reform of **personal insolvency laws**. Previously in Ireland, the only formal mechanism available to settle debts and get protection from creditors for persons deemed insolvent was bankruptcy. Three new debt resolution mechanisms were introduced under the Personal Insolvency Act 2012 for people who cannot afford to pay their personal and mortgage debts. The Insolvency Service of Ireland (ISI) administers these debt resolution processes. The ISI has a website backontrack.ie, aimed at people who are struggling with debt. In addition new measures to support people in mortgage arrears were introduced, including, as of November 2015, a court review where a mortgage lender rejects the borrower's personal insolvency proposal. Furthermore, the Irish bankruptcy law was amended in 2016 to reduce normal duration of bankruptcy from 3 years to 1 year (up to December 2013 it was 12 years) among other changes to improve and streamline the process. The Official Assignee in Bankruptcy is now based within the ISI.

Spain

In 2014 Spain reformed its insolvency law to facilitate debt restructurings for businesses (write-off, maturity extensions, debt-to-equity swaps). Before the reform, almost 95 percent of companies that started insolvency proceedings used to end up in liquidation. Under the rules, companies need agreement from 60 percent of creditors only to extend debt by five years or to convert debt into participative loans, a hybrid of equity and debt. Individual creditors can also agree to refinance the company during preliminary bankruptcy proceedings, and further amendments were introduced in 2015 to modify out-of-court refinancing.

5. Financial Assistance Programmes

According to Article 18 of the EU Regulation No 472/2013 on strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability representatives of the Council and of the Commission may be invited by the European Parliament to enter into a dialogue on the application of this Regulation. According to the Euro Area spring 2016 work programme it will continue reviewing the macro-financial assistance programme in Greece and, while applicable, in Cyprus. Eurogroup involvement in post-programme surveillance will also carry on as deemed appropriate.

Greece: The COM signed on 19 August 2015 (on behalf of the members of the euro area) a Memorandum of Understanding (MoU) with Greece for a third economic adjustment programme of up to €86 billion. Moreover, the Greek authorities signed an agreement with the ESM to specify the financial terms of the loan. So far €16 billion have been disbursed by the ESM. The first review of the ESM programme is on-going. On 11 February the Eurogroup called on both the Greek authorities and the institutions to pursue the discussions on the review further, in particular on items such as pension reform, the fiscal issues and the privatisation fund, with a view to reaching that staff-level agreement.

Ireland: At the end of 2013, Ireland exited the 3-year-programme (see EC ex-post evaluation of July 2015) and is since then subject to Post-Programme Surveillance (PPS). The latest review mission was completed in November 2015. The mission staff concluded that the adjustment process of the economy has continued; it also reported that non-performing loans of domestic banks remain despite significant decreases among the highest in the euro area and that the share of long-term mortgage arrears continues to increase.

Portugal: Portugal has been subject to PPS/EWS/PPM, after the government decided on 12 June 2014 to exit the programme without disbursement of the full amount of the assistance. The third PPS mission took place in January/February 2016. The teams from the COM and the ECB concluded that the economic recovery continues to be held back by macroeconomic imbalances and rigidities in labour and product markets. Looking ahead, efforts to reduce the underlying structural budget balance and implement an ambitious reform agenda need to be stepped up.

Cyprus: On 6 April 2015, Cyprus lifted its last remaining capital controls. The latest ESM disbursement (of €500 billion) took place on 8 October 2015. Following the completion of the ninth review, the IMF Executive Board concluded that economic and fiscal outcomes were better than expected, non-performing loans stabilised, albeit at high level, and bank liquidity continued to improve. At the same time, measures are needed to overcome delays in implementation of structural reform agenda so as to protect confidence and long-term growth. One more review remains to be completed before the Cyprus' economic adjustment programme ends in March 2016.

An evaluation of the financial assistance provided to EU Member States which have exited macro-economic adjustment programmes (Hungary, Latvia, Romania, Ireland and Portugal) was provided by the European Court of Auditors in January 2016.

For more information on the state of play as regards financial assistance programmes, see a separate EGOV table and EGOV briefing on Greece):

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Annex 1: Key macro-economic indicators for the euro area

	2014	2015	2015(Q1)	2015(Q2)	2015(Q3)	2015(Q4)
Output						
Economic sentiment (indicator)	101.5	104.2	102.6	103.7	104.5	106.3
Industrial confidence (balance)	-3.8	-3.1	-3.9	-3.2	-2.9	-2.4
GDP *(% ch. on prev. year and period*)*	n.a.	n.a	0.5	0.4	0.3	n.a.
GDP (% ch. on prev. year)	0.9	n.a.	1.3	1.6	1.6	n.a.
Labour productivity *(% ch. on prev. period and year*)*	n.a. 0.3	n.a. n.a.	0.3 0.4	0.0 0.6	0.0 0.5	n.a. n.a.
Private consumption						
Consumer confidence (balance)	-10.2	-6.2	-6.2	-5.2	-7.0	-6.4
Private consumption *(% ch. on prev. period and year*)*	n.a. 0.8	n.a. n.a.	0.5 1.6	0.3 1.7	0.4 1.7	n.a. n.a.
Investment						
Gross fixed capital formation *(% ch. on prev. period and year*)*	n.a. 1.3	n.a. n.a.	1.5 2.0	0.1 2.6	0.0 2.2	n.a n.a.
Labour market						
Employment *(% ch. on prev. period and year*)*	n.a. 0.6	n.a. 0.8	0.2 0.9	0.4 1.0	0.3 1.1	n.a. n.a.
Unemployment rate (% of labour force)	11.6	10.9	11.2	11.0	10.7	10.5
International transactions						
World trade *(% ch. on prev. period and year)*	n.a. 3.2	n.a. n.a.	-0.7 3.5	-0.7 2.2	1.9 2.2	n.a. n.a.
Current-account balance (billion €)	245.6	288.0	79.9	79.5	76.5	52.0
Prices						
Core HICP	0.9	0.8	0.6	0.8	0.9	0.9
Headline inflation *(HICP, % ch. on prev. year)*	0.4	0.0	-0.3	0.2	0.1	0.2
Monetary and financial indicators						
Nominal interest rates (3 month)	0.21	-0.02	0.05	-0.01	-0.03	-0.09
Nominal effective exchange rate *(% ch. on prev. period and year*)*	n.a. 0.6	n.a. -9.3	-6.1 -10.2	-1.9 -11.9	1.6 -8.5	-0.3 -6.7

Source: DG ECFIN, data as of 09 February 2016.

Note: *Trade balance*: extra EA exports - extra EA imports. Data seasonally adjusted.
Current account balance: Transactions in goods and services + income and current transfers between residents and non- residents of the EA. Data seasonally and working-day adjusted.
Headline inflation: HICP (index 2005=100).
Nominal interest rates: ECB 3-month EURIBOR interbank rate (360 days).
Nominal effective exchange rate: ECB Nominal effective exch. rate, EA-17 vis-à-vis the EER-20 group of trading partners against Euro.

Annex 2: Implementation of the 2015 recommendations to the euro area as a whole

This annex outlines the Eurogroup's actions as regards follow-up and implementation of the 2015 EA CSRs based on information publicly available as of 12 February 2016.

2015 Council Recommendations to the euro area as a whole	Eurogroup policy actions
EA CSR 1: Use peer pressure to **promote structural reforms that facilitate the correction of large internal and external debts and support investment**. Regularly assess the delivery of reforms in those Member States which require specific monitoring within the framework of the Macroeconomic Imbalances Procedure. Continue the regular thematic assessment of structural reforms. By spring 2016, take decisions on the follow-up to the coordination exercise on reducing the high tax wedge on labour and on reforming services markets.	On 12 September 2015, the Eurogroup discussed possible ways to reduce high tax wedge on labour in the euro area (which is currently the highest in the world). In particular, **Ministers agreed on an informal benchmarking of labour taxation** to allow Member States to compare their situation to that in the other countries when adopting national policies. Given the limited fiscal space, reduction in the tax burden on labour should be accompanied by either equivalent savings in non-productive expenditure or by shifting labour taxes towards taxes that are less detrimental to growth (e.g. consumption tax). On 5 October 2015, **the Eurogroup agreed on general principles to guide services reform**, such as making regulation proportionate and non-discriminatory, ensuring mutual recognition standards in the fields of services markets and professions, reducing non-regulatory barriers. Ministers also welcomed the Commission plan to put forward a new Single Market Strategy later this autumn.
EA CSR 2: Coordinate fiscal policies to ensure that the aggregate euro area fiscal stance is in line with sustainability risks and cyclical conditions. This is without prejudice to the fulfilment of the requirements of the Stability and Growth Pact. By spring 2016, hold thematic discussions on improvements in the quality and sustainability of public finances, focussing in particular on the prioritisation of tangible and intangible investment at national and EU levels, and on making tax systems more growth friendly. Monitor the effective functioning of the recently strengthened national fiscal frameworks.	On 13 July 2015, **the Commission informed Ministers about the state of play as regards its review of the Fiscal Compact** (i.e. implementation of its budgetary provisions). Eurogroup President observed after the meeting that *"This could actually be an interesting test case of how serious we are about implementation"*. On 5 October 2015, **the Eurogroup held its first discussion on the process regarding the 2016 draft budgetary plans** (DBPs), in particular the Spanish DBP which was submitted ahead of the schedule (namely 15 October). A dedicated discussion on DPBs is to take place at the Eurogroup meeting of 23 November 2015. The Eurogroup also confirmed that **euro area Member States should use windfall gains stemming from the currently low interest rates on government debt primarily for fiscal consolidation**, and for investment or structural reforms, if country-specific situation allows to do so. On 23 November 2015, **Ministers discussed the 2016 DBPs and broadly concurred with the COM opinions** published on 17 November 2015. The Eurogroup took note that no DBP was found in serious non-compliance and called on Portugal to submit its DBP as soon as possible. Ministers also acknowledged the progress euro area Member States have made on the fiscal side: the number of countries under the corrective arm of the SGP is set to decline from 15 to 3 between 2010 and 2016 while the aggregate debt-to-GDP ratio is set to decline in 2015 for the first time since 2007. On 7 December 2015, the **Eurogroup held a thematic discussion on pensions and pension reforms**, considered central to fiscal sustainability in the euro area. **Alongside addressing pension expenditures, Ministers also acknowledged the need to ensure that**

	retirement income remains sufficient in the future. Moreover, they discussed the challenge of addressing the costs associated with population aging in a sustainable manner. On 11 February 2016, the Eurogroup held a **thematic discussion on the quality of public expenditure in the euro area.** Ministers agreed that (1) it is important to make public spending more efficient to enhance the euro area's potential for economic growth and (2) to further discuss specific areas of public spending. The Eurogroup will pay particular attention to investment, healthcare and ageing-related expenditure at the upcoming Eurogroup meetings.
EA CSR 3: Ensure the timely finalisation of the follow up of the Comprehensive Assessment carried out by the European Central Bank, implementation of Directive 2014/59/EU of the European Parliament and of the Council (Bank Recovery and Resolution Directive), completion of the ratification of the Intergovernmental Agreement on the Single Resolution Fund and make the Fund fully operational as from January 2016. **Promote measures to deepen market-based finance**, to improve access to finance for SMEs and to develop alternative sources of finance. **Encourage further reforms of national insolvency frameworks.**	Following the Eurogroup meeting of 13 July 2015, the ECOFIN Council adopted on 14 July 2015 **a decision clarifying the application of rules of procedure under Regulation 806/2014 on the Single Resolution Mechanism** (i.e. Council decisions are to adopted by a written vote on the basis of documents and drafts that are to be drawn up in English only). On 12 September 2015, **the Commission informed Ministers on the implementation process of both BRRD and the IGA**. These elements are to be fully operational on 1 January 2016. On 9 November 2015, **Ministers discussed the BRRD and specifically setting up of the SRB**. In this context, the discussion focused on two particular elements: (1) setting up of the national credit lines and (2) timely ratification of the IGA and transposition of the BRRD by all the Member States. On 7 December 2015, **Danièle Nouy, Chair of the SSM, reported to the Eurogroup,** under the accountability arrangements for the SSM, on activities over the past six months, including the recent comprehensive assessment of nine banks and the implementation of the SSM's legal and methodological framework. On 14 January 2016, **the Eurogroup exchanged views on national insolvency frameworks and their application, which differ widely across Member States**. Ministers agreed to establish a set of common principles and benchmarks to improve efficiency and effectiveness of these frameworks. The Eurogroup is to continue to discuss these elements in spring 2016.
EA CSR 4: Take forward work on **deepening Economic and Monetary Union**, and contribute to the improvement of the economic surveillance framework in the context of the report on the next steps on better economic governance in the euro area, prepared by the President of the European Commission, Jean-Claude Juncker, in close cooperation with the President of the European Council, Donald Tusk, the President of the European Parliament, Martin Schulz, the President of the European Central Bank, Mario Draghi, and the President of the Eurogroup, Jeroen Dijsselbloem, and its follow-up.	On 13 July 2015, **Ministers exchanged views on the Five president's report on completing EMU and expressed strong support for taking steps to move this process forward**. While many new mechanisms and instruments have been put in place during the last five years, the Eurogroup acknowledged the need to further strengthen the existing framework. A subsequent discussion within ECOFIN focused, among others, on short-term measures. To this end, **the Commission unveiled on 21 October 2015 a series of measures to start the completion of the EMU**, namely (1) a revamped European Semester, including through enhanced democratic dialogue; (2) improved economic governance, via introduction of national Competitiveness Boards and an advisory European Fiscal Board; (3) a more unified representation of the euro area in international financial institutions,

	especially within the IMF and (4) steps towards the Financial Union, in particular those aimed at completing the Banking Union (notably via a European Deposit Insurance Guarantee Scheme) as well as measures to further reduce risk in the banking system, inter alia via establishment of a Capital Union. On 9 November 2015, **the Eurogroup held an initial exchange of views on the COM communication of 21 October 2015** and specifically on external representation of the euro area.

Annex 3: Overview and assessment of the Council recommendations to the euro area as a whole

Council 2015 recommendations	Assessment of implementation of 2015 recommendations (based on COM Staff Working Document)	Council draft 2016 recommendations
1. Use peer pressure to promote structural reforms that facilitate the correction of large internal and external debts and support investment. Regularly assess the delivery of reforms in those Member States which require specific monitoring within the framework of the **Macroeconomic Imbalances Procedure**. Continue the regular thematic assessment of structural reforms. By spring 2016, take decisions on the follow-up to the coordination exercise on **reducing the high tax wedge on labour** and on **reforming services markets**.	The euro area has made **limited progress** in addressing **CSR 1**: • Progress in delivering reform commitments has been promoted at the euro area level, via i.a. technical discussions in Economic Policy Committee and Economic and Financial Committee and political discussion in Eurogroup and ECOFIN. Programme countries' reform progress, as well as discussion on reform progress in member states with excessive imbalances or imbalances requiring decisive action, has also taken place. • The Eurogroup has held thematic discussions on reducing the high tax wedge on labour, inter alia agreeing on a benchmarking exercise, as well as on reforming services markets.	**1. Pursue policies that support the recovery, foster convergence, facilitate the correction of macroeconomic imbalances and improve adjustment capacity.** To this end, Member States, particularly those with large stocks of private and foreign debt, should implement reforms that enhance productivity, foster job creation, raise competitiveness and improve the business environment. Member States with large current account surpluses should implement as a priority measures, including structural reforms, that help strengthen their domestic demand and growth potential. **2. Implement reforms** that combine (i) **flexible and reliable labour contracts** that promote smooth labour market transitions and avoid a two-tier labour market; (ii) comprehensive **lifelong learning** strategies; (iii) effective policies to help the **unemployed re-enter the labour market**, (iv) **adequate and sustainable social protection systems** that contribute effectively and efficiently throughout the life cycle both to social inclusion and labour market integration and, (v) **open and competitive product and services markets. Reduce the tax wedge on labour,** particularly on low-earners, in a budgetary-neutral way to foster job creation.
2. Coordinate fiscal policies to ensure that the aggregate euro area fiscal stance is in line with sustainability risks and cyclical conditions. This is without prejudice to the fulfilment of the requirements of the Stability and Growth Pact. By spring 2016, hold thematic discussions on improvements in the quality and sustainability of public finances, focussing in particular on the prioritisation of tangible and intangible **investment** at	The euro area has made **some progress** in addressing **CSR 2**: • Assessments of the euro area fiscal stance have been carried by the Eurogroup, notably by reviewing the implementation of the Two-pack and discussing the implications of the Commission services' autumn 2013 and 2015 forecast for fiscal surveillance.	**3. Pursue fiscal policies in full respect of the Stability and Growth Pact.** For 2016, the objective of a broadly neutral aggregate fiscal stance in the euro area appears appropriate in order to reflect a balance between long-term fiscal sustainability and short-term macroeconomic stabilisation. With a view to 2017, reduce public debt to restore fiscal buffers and avoid pro-cyclicality. Differentiate the fiscal effort by individual Member States

national and EU levels, and on making **tax systems more growth friendly**. Monitor the effective functioning of the recently strengthened national fiscal frameworks.	• The Eurogroup has held thematic discussions on fiscal frameworks. • In the EMU Package on 21 October 2015, the Commission published its decision to set up an European Fiscal Board to act as an independent advisory body. Its mandate will include to evaluate how fiscal governance framework was implemented, to advise on the euro area fiscal stance and to cooperate with the national fiscal councils. • Some progress has been made on the coordination of fiscal policies, in particular in the context of the assessment of the draft budgetary plans, to the extent that fiscal outlook for the euro area as a whole has improved and the aggregate fiscal stance seems appropriate. However, the distribution of the fiscal stance remains sub-optimal.	in line with their respective positions vis-à-vis the requirements under the SGP while considering stabilisation needs, as well as taking into account possible spillovers across euro area countries. To this end, review the euro area fiscal stance in the context of the Stability Programmes and the Draft Budgetary Plans.
3. Ensure the timely finalisation of the follow up of the Comprehensive Assessment carried out by the European Central Bank, implementation of Directive 2014/59/EU of the European Parliament and of the Council (1) (Bank Recovery and Resolution Directive), completion of the ratification of the Intergovernmental Agreement on the Single Resolution Fund and make the Fund fully operational as from January 2016. **Promote measures to deepen market-based finance**, to improve access to finance for SMEs and to develop alternative sources of finance. **Encourage further reforms of national insolvency frameworks.**	The euro area has made **substantial progress** in addressing **CSR 3**: • The ECB Single Supervisory Mechanism (SSM) became fully operational and responsible for direct supervision of the most significant euroarea banks. The asset quality review (the comprehensive assessment) of 130 banks was completed and the SSM started work towards further harmonisation of bank supervisory and regulatory treatment across the euro area. • The establishment of the Single Resolution Board (SRB) and of the Single Resolution Fund (SRF) advanced according to plans in 2015. Work also progressed towards agreeing bridge financing arrangements for the SRF and towards the establishment of a common backstop for the SRF during the transition period.	**4. Facilitate the gradual reduction of banks' non-performing loans and improve insolvency proceedings for businesses and households.** In Member States with large stocks of private debt, promote an orderly deleveraging, including by facilitating the resolution of unviable private debt.

	• On 30 September 2015 the Commission launched the Capital Markets Union (CMU) Action Plan, aiming at boosting business funding and investment financing by building a single market for capital across the EU. This initiative will enable the development of alternative sources of finance complementary to bank-financing and to break down barriers blocking cross-border investments in the EU. CMU should be particularly beneficial to SMEs and start-ups. Preparatory work has started and consultations are gearing up towards a legislative proposal for principles-based minimum harmonisation of business insolvency.	
4. Take forward work on deepening Economic and Monetary Union, and contribute to the improvement of the economic surveillance framework in the context of the report on the next steps on better economic governance in the euro area, prepared by the President of the European Commission, Jean-Claude Juncker, in close cooperation with the President of the European Council, Donald Tusk, the President of the European Parliament, Martin Schulz, the President of the European Central Bank, Mario Draghi, and the President of the Eurogroup, Jeroen Dijsselbloem, and its follow-up.	The euro area has made **some progress** in addressing **CSR 4**: • On 21 October 2015 the Commission adopted a package of measures to further strengthen and deepen the Economic and Monetary Union. It followed up on the Five Presidents' Report published in June, which was based on a wide consultation with the Member States. • The package proposals included measures to revamp the EU Semester, in particular by strengthening its euro area dimension, it presented proposals for an improved toolbox of economic governance, including a recommendations to establish national Competitiveness Boards and a proposal for a more consistent external representation of the euro area.	**5. Work towards completing the Economic and Monetary Union,** in full respect of the internal market and in an open and transparent manner, further exploring the legal, economic and political aspects of the more long-term measures contained in the Five Presidents' Report.

Annex 4: Fiscal sustainability assessment by Member State

	BE	BG	CZ	DK	DE	EE	IE	ES	FR	HR	IT	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK
Overall short-term risk[1]	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low	low
Overall medium-term risk[2]	high	low	low	low	low	low	high	high	high	high	high	low	medium	low	medium	low	medium	medium	medium	high	high	high	low	high	low	high
Debt sustainability risk[3]	high	low	low	low	low	low	high	high	high	high	high	low	low	low	medium	low	medium	medium	medium	high	high	high	low	high	low	high
Overall long-term risk[4]	medium	medium	medium	low	low	low	low	low	low	low	low	low	medium	medium	low	medium	medium	medium	medium	low	medium	high	medium	medium	medium	medium

Source: European Commission, Fiscal Sustainability Report 2015, January 2016 (Member States under macroeconomic adjustment programme are not included).

Note:

1. Based on the S0 indicator used by the European Commission, this indicator highlights risks of fiscal stress in the upcoming year. It is based on 28 individual variables, grouped into two sub-indicators (Fiscal index and Financial-competitiveness index).
2. Based on the joint measure of the debt sustainability analysis (DSA) and the S1 indicator. The DSA makes use of debt projections over 10-years, with both baseline (no-fiscal policy change) and alternative scenarios (e.g. to take into account less favourable ageing costs). The S1 indicator shows the additional cumulated adjustment in the structural primary balance over 5 years that is needed to reach the target of a 60% debt-to-GDP ratio by 2030. Like for the DSA, the S1 can be measured against alternative scenarios. Countries are assessed against a lower (0 pps.) and upper (2.5 pps.) threshold of required adjustment, with medium risk for countries ranked between. A country is considered to have a high medium-term debt sustainability risk if either its DSA or its S1, or both, show a high medium-term risk.
3. Based on DSA (see previous footnote).
4. Based on the S2 indicator, it shows the upfront adjustment to the current structural primary balance required to stabilize the debt-to-GDP ratio over the infinite horizon (irrespective of any debt-to-GDP ratio targets). Two thresholds of risks are set in terms of adjustment percentage points: an upper threshold of 6pps. and a lower threshold of 2 pps. Countries above 6 pps. are considered to be at high long-term risk, countries between 6 and 2 pps. at medium risk, countries below 2 pps. at low risk. It can be measured against alternative scenarios.