IN-DEPTH ANALYSIS

European Parliament

**EGOV**
ECONOMIC GOVERNANCE AND EMU SCRUTINY UNIT

ECONOMIC GOVERNANCE

# Economic Dialogue with the President of the ECOFIN


*[Nadia Calvinho](), First Vice President of the Government of Spain, Minister for Economic Affairs and Digital Transformation is participating in the ECON Committee in her capacity of President of the ECOFIN Council during the Spanish Presidency (July - December 2023). In accordance with the Treaty of the Union, "Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council".*

*This document provides an overview of the Spanish Presidency priorities in ECON matters, including the Council's work relating to the implementation of the European Semester for economic coordination, notably the application of the Recovery and Resilience Facility, and other policy streams relevant to the EU single market and the deepening of the Economic and Monetary Union, including the review debate on the EU economic governance framework.*


## 1. The ECON-related priorities of the Spanish Presidency

The Spanish Presidency's priorities in the Economic and Financial Affairs Council include the following policy areas inter alia:

- **Reform of the economic governance framework** by promoting a revision of the Stability and Growth Pact to adapt the fiscal rules applicable to national budgets
- Promote the **mid-term review of the Multi-annual Financial Framework 2021-2027**, a debate closely linked to the issue of financial aid for Ukraine and other key economic initiatives
- Work towards the **approval of new own resources for the EU**, aimed at repaying the loans that financed the Next Generation EU investment programme, thus contributing to equip the EU with greater financial capacity
- Strive to reinforce the **bank crisis management framework** by improving bank resolution and deposit guarantee systems and work towards bolstering the **Capital Markets Union**, advancing the sustainable financing agenda, promoting the **digital euro**, and implementing the regulatory package addressing the prevention of **money laundering and terrorism financing**


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PE 747.869 - September 2023


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- Formulate a robust European strategy that **strengthens the EU's competitiveness and strategic autonomy**, achieved through regulatory reforms preserving the internal market's integrity, fostering competitiveness, supporting strategic projects, and revising competitiveness policies, State aid control, and cohesion regulations.
- Expedite files on **corporate, indirect and customs taxation** with the aim of streamlining the burden for individuals and companies, and to combat tax evasion and avoidance.

The **informal ECOFIN Council** meeting in *Santiago de Compostela* on 15-16 September 2023 was a key opportunity to advance on these priorities. The minsters discussed among other topics the "*Interaction of fiscal and monetary policy*" and "*Strategic autonomy, economic security and the provision of EU public goods*". The ministers also took stock of the economic governance review debate.

The Council published the **Draft agendas for Council meetings** **during the Spanish Presidency** to discuss those topics. The **draft October ECOFIN agenda** includes *inter alia* the following items:

- progress reports on the EU economic governance reform review (see Section 4.1 below),
- implementation of the Recovery and Resilience Facility (see Section 3.1 below),
- exchange of views on the economic and financial impact of Russia's aggression against Ukraine (see Section 2 below),
- exchange of views on lessons learnt and way forward on the European Semester (see Section 3 below), and
- exchange of views on artificial intelligence: embracing its impact on productivity and preparing its effects on employment.

**Profile of the Minister**

Nadia Calviño: Since January 2020 Minister for Economic Affairs and Digital Transformation and, since July 2021, First Vice-President of the Government of Spain. She is also currently in charge of representing Spain in EU and international financial institutions.

The Spanish government has currently nominated Ms Calviño as the candidate to succeed to Werner Hoyer as President of the European Investment Bank (EIB) after his mandate expires at the end of 2023.

**Relevant previous positions**

- Minister for the Economy and Business (2018-2020)
- Director General, DG Budget, European Commission (2014-2018)
- Deputy Director-General, Financial Services, DG Internal Market and Services, European Commission (2010-2014)
- Deputy Director General, Mergers and Antitrust, DG Competition, European Commission (2006-2010)
- Spanish civil service covering, among others, foreign trade, macroeconomic analysis and forecasting, economic policy, competition, Ministry for Economic Affairs (1994-2006)
- Professor of Political Economy and Financial System at Universidad Complutense de Madrid (1991-1994)

**Academic background**

- Degree in economics from Universidad Complutense de Madrid (1991)
- Degree in law from Universidad Nacional de Educación a Distancia (2001)

**Caretaker government**

She is currently the Vice-President of a caretaker government after the results of the July elections indicated the lack of a clear government majority. The King of Spain Felipe VI has invited the leader of the centre-right Partido Popular Alberto Núñez Feijóo to attempt to form a government.

***Box 1: ECON related legislative work during autumn***

Files in trilogues:

- **AML package** (1) mechanisms for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, (2) establishment of the Authority for AML and Countering the Financing of Terrorism, (3) prevention of the use of the financial system for the purposes of money laundering and terrorist financing)
- **Solvency II review and Insurance Recovery and Resolution Directive:** (1) reform of insurance supervision, including proportionality and quality of supervision and (2) proposal for a directive on insurance crisis management
- **Instant Payments** proposal for a regulation to promote instant payments in euro

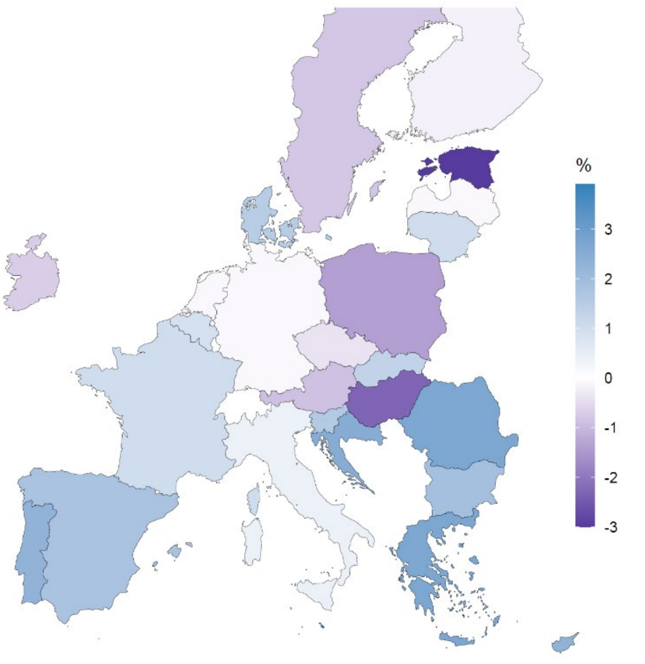
Files not yet under inter-institutional negotiations:

- **Economic governance review** (1) SGP preventive arm, (2) SGP corrective arm, (3) Directive of national IFIs).
- **Clearing package** (1) Regulation amending *inter alia* the European Market Infrastructure Regulation (EMIR); (2) Directive amending *inter alia* the Capital Requirements Directive (CRD)
- **Listing package** (1) proposal for a directive on multiple-vote share structures, (2) proposal amending the Markets in Financial Instruments Directive, (3) proposal amending *inter alia* the Prospectus Regulation
- **Retail investment package** (1) proposal for an omnibus directive on retail investor protection, (2) proposal to modernise Key Information Documents for Packaged Retail Investment and Insurance Products
- **Digital euro package** (1) proposal on the legal tender status of banknotes and coins, (2) proposal establishing the digital euro, (3) proposal on digital euro services by providers outside the euro zone
- **PSD review package** (1) proposal for a regulation on payment services in the internal market, (2) proposal for a directive on payment and electronic money services
- **ESG ratings** proposal for a Regulation on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities
- **Banking resolution crisis management reform** (1) amending the Bank Recovery and Resolution Directive, (2) amending the SRB Regulation, (3) amending the Deposit Guarantee Schemes Directive)

## 2. Latest economic developments

**The European economy continues to grapple with the challenges of high inflation and an aggregate economic slowdown**. The Summer 2023 Economic Forecasts of the European Commission revised down growth expectations for the EU to 0.8% in 2023 (from 1% in the Spring forecasts) and to 1.4% next year (from 1.7%). The Commission also slashed growth estimates for the euro area to 0.8% (from 1.1%) and 1.3 %( from 1.6%) for 2023 and 2024, respectively. *The economic slowdown is particularly affecting industry and services, as indicated by established purchasing managers' indices (see for example here).”* Business activity is deteriorating also in large EU economies such as Germany and France. The Commission indicates that weaker domestic demand, due to persistent inflationary pressures, and the bank credit crunch driven by the ongoing monetary tightening are having a toll on economic growth.

**Figure 1:** Differences in GDP growth rates (in %) in EU member states



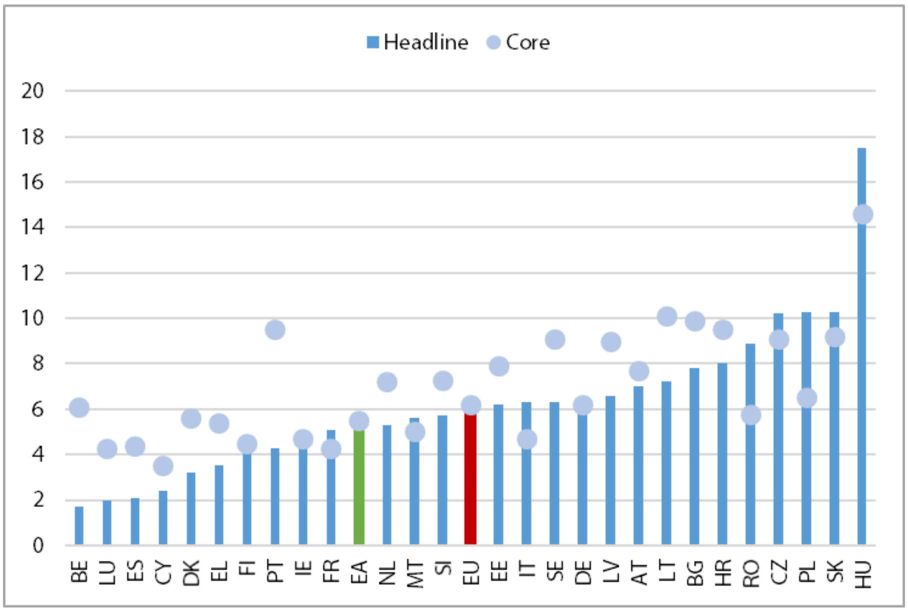

Note: Data refers to seasonally adjusted year-on-year growth rates for second quarter of 2023.
*Source: Eurostat.*

Despite improvements in the global economic performance, weak external demand is also expected to continue to weigh on European growth.

**Headline inflation, as measured by the harmonised index of consumer prices (HICP), has been easing over the course of 2023,** down from a 10.6% peak in the euro area in October 2022. According to Eurostat, in the euro area, it currently sits at 5.3% (August 2023).

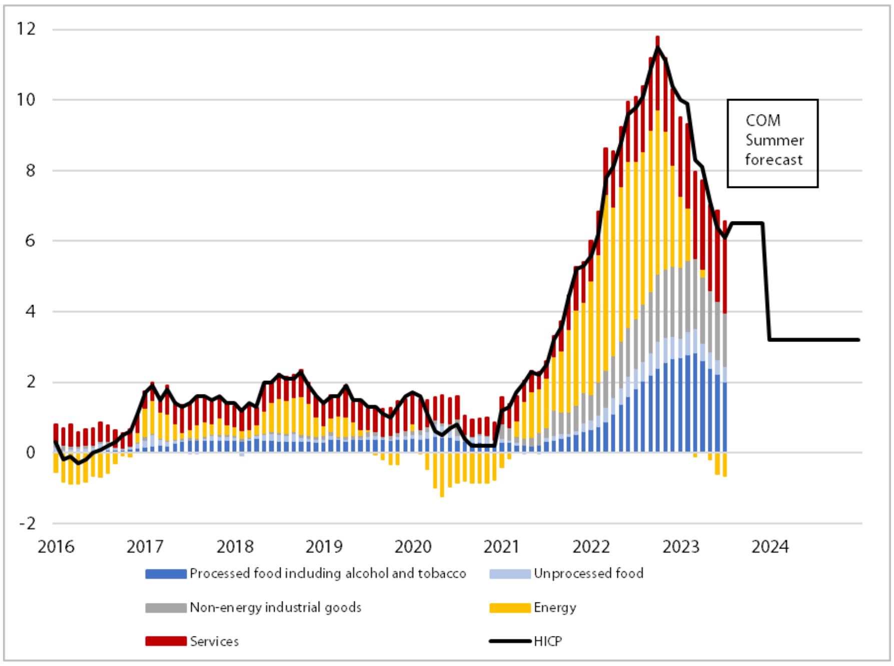
The Commission expects headline inflation to decline to 6.5% for the EU (from 9.2% in 2022) and to 5.6% (from 8.4% in 2022) in the euro area by the end of the year. Despite continuing to fall in 2024, headline inflation will still remain above the 2% target (3.1% in the EU, 2.9% in the euro area). **Core inflation (i.e. excluding energy and food) remains strong and persistent, amidst a reduction in energy prices, strong services inflation and tight labour markets (Figure 2)**. Overall, energy prices are expected to continue to decline in the second half of the year before a slight rebound in 2024 due to increasing oil prices. **Figure 3** shows the breakdown of headline EU inflation in its main components.

**Figure 2:** Headline vs core inflation (in %) in July 2023 in EU Member States




*Source: Eurostat.*

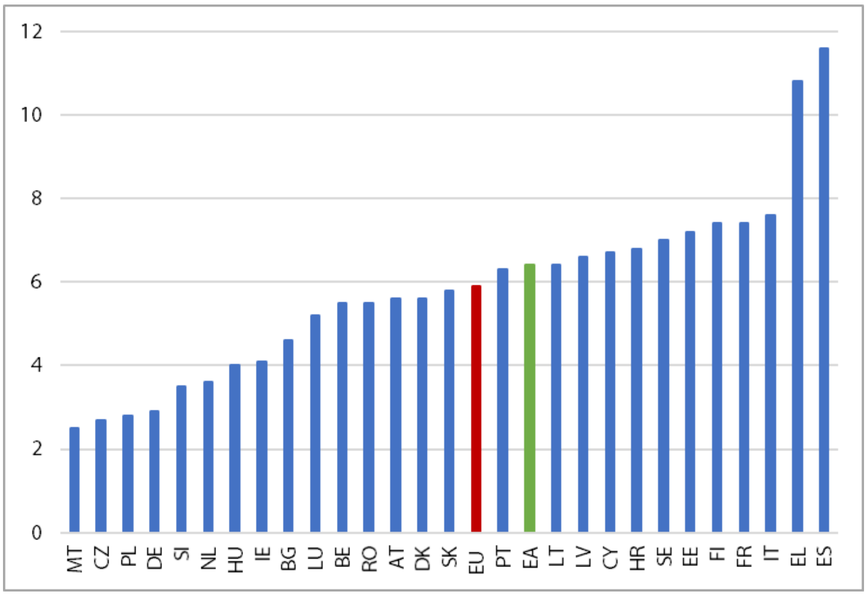
**Figure 3:** Inflation breakdown in EU (in percentage points)




Note: Last data refer to July 2023. Forecast data is provided by the European Commission Summer 2023 Economic Forecast.
*Source: Eurostat; EGOV's own calculation.*

**The 2023 Summer forecast highlight the tightness of labour market, with record low unemployment rates, increased employment and rising nominal wages.** As of July, the EU unemployment rate stood at historic low levels at 5.9% in the EU and 6.4% in the euro area (**Figure 4**). According to the Eurostat data unemployment rates ranged from 2.5% in Malta to 11.6% in Spain in July 2023. According to the Commission, recent survey data point towards a cooling of the labour market among expectations for deteriorations in Spain, Poland and Netherlands. While nominal wages continue to rise, real wages continue to fall, though at a slower pace.

**Figure 4:** Unemployment rate (in %) in July 2023 in EU Member States




Note: Unemployment rates are seasonally-adjusted; % of population in the labour force.
*Source: Eurostat.*

**Against this backdrop, the ECB has continued the tightening of its monetary policy stance. Since July 2022, the ECB Governing Council has hiked its key interest rates by 450 basis points (bps).** On 14 September 2023, ECB President Lagarde has announced a 25 bps interest rate increase, bringing the deposit facility rate (DFR) to 4.00%, the main refinancing operation (MRO) rate to 4.5% and the rate on the marginal lending facility (MLF) rate to 4.75%[1]. In the meantime, the ECB is continuing the gradual unwinding of its balance sheet, mostly through banks' early repayment of Targeted Longer Term Refinancing Operations (TLTROs). The ECB is also stopping reinvestments of the proceeds of securities maturing under its asset purchase programme (APP).

**Despite a slowdown in bank credit provision to the private sector, showing the effective transmission of the monetary policy stance, the EU banking sector remains robust.** The results of the recent 2023 EU-wide stress test by the European Banking Authority show the resilience of European banks even under an adverse scenario. Banks are also temporarily benefitting from the current increase in interest rates by higher profit margins, which has prompted Member States like Spain and Italy in imposing windfall tax measures on banks. The ECB however expects interest rates on deposit to increase as a consequence of excess liquidity dries up. Furthermore, it has indicated that rising funding costs and a deterioration of asset quality could negatively affect banks' profitability.

**On sovereign debt markets, the increase in interest rates, in line with expectations, is moving yields upwards yet slowly.** The Commission has found that spreads among sovereign yields remain constant and has even highlighted a narrowing for the lowest rated Member States (Italy and Greece).

[1] The related monetary policy statement say: "*Based on its current assessment, the Governing Council considers that the key ECB interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target*".

**Table 1:** Recent euro area real GDP, headline and core inflation forecasts (annual changes)

<table>
<tr><th colspan="2">Source</th><th>2023</th><th>2024</th></tr>
<tr><td rowspan="3">ECB staff macroeconomic projections (September 2023)<br>Revision from June 2023</td><td>Real GDP</td><td>0.7%<br>↓0.2 p.p.</td><td>1.0%<br>↓0.5 p.p.</td></tr>
<tr><td>Headline</td><td>5.6%<br>↑0.2 p.p.</td><td>3.2%<br>↑0.2 p.p.</td></tr>
<tr><td>Core[2]</td><td>5.1%<br>=</td><td>2.9%<br>↓0.1 p.p.</td></tr>
<tr><td rowspan="3">IMF World Economic Outlook (July 2023)<br>Revision from April 2023</td><td>Real GDP</td><td>0.9%<br>↑0.1 p.p.</td><td>1.5%<br>↑0.1 p.p.</td></tr>
<tr><td>Headline</td><td>5.2%<br>↓0.1 p.p.</td><td>2.8%<br>↓0.1 p.p.</td></tr>
<tr><td>Core</td><td>n/a</td><td>n/a</td></tr>
<tr><td rowspan="3">European Commission (September 2023)<br>Revision from May 2023</td><td>Real GDP</td><td>0.8%<br>↓0.3 p.p.</td><td>1.4%<br>↓0.2 p.p.</td></tr>
<tr><td>Headline</td><td>5.6%<br>↓0.2 p.p.</td><td>2.9%<br>↑0.1 p.p.</td></tr>
<tr><td>Core[3]</td><td>n.a.</td><td>n.a.</td></tr>
<tr><td rowspan="3">OECD (June 2023)<br>Revision from March 2023</td><td>Real GDP</td><td>0.9%<br>↑1.0 p.p.</td><td>1.5%<br>=</td></tr>
<tr><td>Headline</td><td>5.8%<br>↓0.4 p.p.</td><td>3.2%<br>↑0.2 p.p.</td></tr>
<tr><td>Core[4]</td><td>5.4%<br>↑0.2 p.p.</td><td>3.6%<br>↑0.6 p.p.</td></tr>
</table>

## 3. Economic coordination under the European Semester Cycle 2023

On 16 June, the Council agreed its 2023 country-specific recommendations (CSRs) on the Member States' fiscal, economic and employment policies and on 29-30 June, the European Council held a discussion on the CSRs as discussed by the Council[5].

**During the pandemic the European Semester was not fully applied**. Now, during the 2023 Semester Cycle, the Commission and Council have returned to a wider use of the Semester framework complementing the implementation of the Recovery and Resilience Plans (RRPs).

Building on the Commission country reports' analysis, the Commission proposals for Council 2023 CSR provide guidance to Member States on tackling key economic and social challenges that are only partially addressed or not addressed by the RRPs.

The **2023 CSRs are divided into four subparts**:

1. a recommendation on **fiscal policy**, including fiscal and structural reforms, where relevant;
2. a recommendation to continue or accelerate **implementation of the RRP**, including its revisions and the integration of REPowerEU chapters, taking into account potential country-specific implementation risks, and to swiftly implement the adopted cohesion policy programmes;

[2] The ECB's measure of core inflation excludes all food and energy.

[3] The European Commission's measure of core inflation excludes unprocessed food and energy. The Summer 2023 forecasts are only produced on an interim basis and do not provide for core inflation estimates.

[4] HICP excluding food, energy, alcohol and tobacco.

[5] The Council proceeds with the formal adoption of the final texts after the European Council has discussed them, in accordance with Article 121(2) TFEU.

3. an updated recommendation on the clean **energy transition,** in line with the REPowerEU objectives;

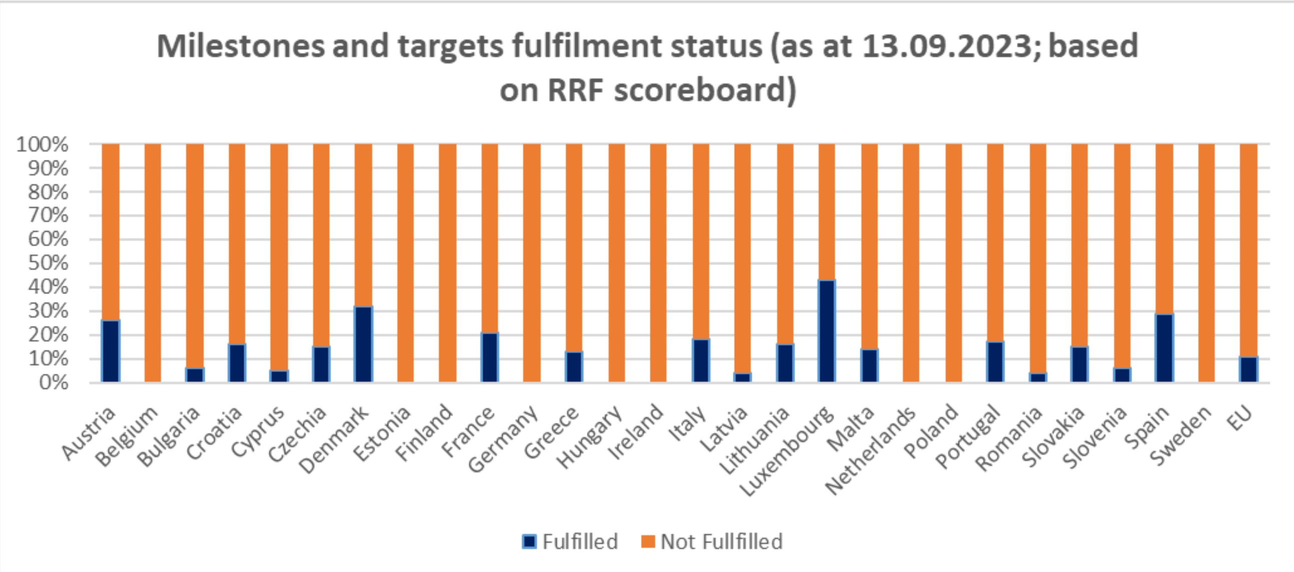
4. where relevant, an additional recommendation on outstanding and/or newly emerging **economic or employment challenges**.

According to current EU law, the Council shall approve the CSRs as recommended by the Commission or explain publicly any changes introduces **"i.e. comply or explain principle**". This year, the Council changes the Commission's recommendations on the timing to withdraw energy prices related fiscal measures (see below) and made a material change to the CSR for Greece (see here [EGOV comparison document](#)).

## 3.1. Implementation of the Recovery and Resilience Facility

At the Council (ECOFIN) [press conference](#) in July 2023, Vice-President Dombrovskis mentioned in relation to the **Recovery and Resilience Facility** (RRF) that ECOFIN adopted three revised national plans that include REPowerEU chapters (France, Malta and Slovakia), that the Commission is assessing a number of other revised plans (including that from Ireland), expecting more to arrive over the summer, and he concluded by urging Member States to **press ahead with the actual implementation** of the plans.

Looking at the RRF Scoreboard, which is the Commission's information platform that documents the progress of the national recovery and resilience plans, the call for urgency is graspable: By mid of September 2023, two and a half years after the facility entered into force, a **mere 11% of all milestones and targets have so far been "fulfilled"** at EU level (for the progress of individual countries, see chart below). The "fulfilment" is a more demanding measure, as it requires that the agreed milestones and targets have actually been implemented and invoiced by the Member State in form of a payment request, that payment request also needs to have been checked and approved both by the Commission and the Council; there may therefore be a somewhat larger share of milestones and targets that have already been implemented, with only their financial settlement pending, but the information that is available in the public domain at least gives some reason for concern.




There are **seven countries** that have so far either not yet received any money at all, or have only received the pre-financing tranche, namely Belgium, Finland, Germany, Hungary, Netherlands, Poland, and Sweden, but the **submission and/or settlement of their first payment request is still pending**.

Under the **REPowerEU** regulation, which entered into force in March 2023, Member States wishing to benefit from an increased financial envelope of the RRF have to modify their recovery and resilience plan to include therein a REPowerEU chapter, with related reforms and investments. As part of the revisions of their RRPs, **ten Member States have requested additional loan support** (Greece, Poland, Portugal and Slovenia) or requested loan support for the first time (Belgium, Czechia, Spain, Croatia, Lithuania and Hungary) for a total additional amount of EUR 127 billion (see Commission's overview of 1 September 2023). It appears that four countries have submitted modified RRPs that do not include REPowerEU chapters (Finland, Germany, Luxembourg and Ireland), and that Bulgaria has not yet submitted an updated RRP with an REPowerEU chapter.

As regards the **list of the 100 largest final recipients** per country that the EP obliged Member States to make available to increase transparency, one may note that as at mid-September 2023, the Commission's RRF Scoreboard only gives details for recipients in 16 countries; **information for recipients in 11 countries**, namely Belgium, Bulgaria, Denmark, France, Greece, Ireland, Luxembourg, Malta, the Netherlands, Romania and Spain, **is still pending**.

## 3.2 Fiscal policy recommendations and coordination

### The 2023 Council fiscal policy recommendations

The fiscal Country-Specific Recommendations (CSRs) per Member State offer EU fiscal guidance for 2023 and 2024. These recommendations, adopted by the Council, are based on the Commission's recommendations from May 2023 and current SGP provisions.

With the SGP general escape clause expiring end-2023, the new legal framework still depends on ongoing political negotiations (see dedicated section below). At the same time, in order to allow for an effective bridge to the future fiscal rules in the context of the Economic Governance Framework, and to take into account current challenges, some elements of the Commission's reform proposal that are consistent with the current legislation are already incorporated by the Commission and the Council into this year's cycle.

In particular, the fiscal recommendations are quantified in terms of **net primary expenditure growth**, derived from fiscal sustainability considerations and the SGP's call for an annual improvement in the structural budget balance toward the medium-term objective by 0.5% of GDP as a benchmark (see **Table 2** below).[6]

**Beyond 2024,** Member States are encouraged to adopt medium-term fiscal strategies to progressively improve their budgetary positions through sustainable consolidation, investments, and long-term growth-enhancing reforms. **Prudent medium-term fiscal stances should be the goal.**

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[6] The Commission outlined in its Communication from 8 March that Member States were invited to set out fiscal targets in their stability and convergence programmes that comply with the fiscal adjustment criteria set out in the Commission's reform orientations. They were also invited to discuss how their reform and investment plans are expected to contribute to fiscal sustainability and sustainable and inclusive growth, including the green and digital transition and resilience objectives, in line with the criteria set out in the reform orientations. At the time, the Commission therefore, announced that it stood ready to propose fiscal policy recommendations for 2024 that are:

- in line with the fiscal targets Member States set out in their stability and convergence programmes, so long as those targets are consistent with ensuring that the public debt ratio is put on a downward path or stays at a prudent level and that the budget deficit is below the 3% of GDP reference value over the medium term;

- quantified and differentiated on the basis of Member States' public debt challenges;

- formulated on the basis of net primary expenditure, as proposed in the Commission's reform orientations.

In addition, the Commission will continue to emphasise public investment in its CSRs on fiscal policy. All Member States should continue to protect nationally financed investment and ensure the effective use of funds under the RRF and other EU funds, in particular for the green and digital transitions and resilience objectives. The CSRs will also provide guidance regarding the fiscal cost of energy measures.

**For countries that have achieved their medium-term budgetary objectives,** the recommendation is to **maintain prudent fiscal positions in 2024**.

**All other Member States are advised to pursue cautious fiscal policies**, specifically by **restricting the increase in nationally-financed net primary expenditure**. Notably, Member States yet to achieve their medium-term budgetary objectives are expected to make **annual fiscal adjustments equivalent to 0.5%** of GDP.

The Commission will continue monitoring Member States' economic and budgetary situation. In the autumn, the Commission will adopt opinions on euro area Member States' **Draft Budgetary Plans**, to ensure that the 2024 budgets are consistent with 2023 fiscal CSRs. In spring 2024, the Commission will propose to the Council to open **deficit-based Excessive Deficit Procedures** on the basis of the outturn data for 2023, in line with existing legal provisions.

**Table 2:** 2023 CSRs : quantitative fiscal recommendation for 2024

| Country | Limiting nationally financed net primary expenditure | Corresponding to an annual improvement in the structural budget balance | Country | Limiting nationally financed net primary expenditure | Corresponding to an annual improvement in the structural budget balance |
|---|---|---|---|---|---|
| **BE** | 2% | 0,7% | **MT** | 5,9% | 0,5% |
| **DE** | 2,5% | 0,3% | **NL** | 3,5% | 0,3% |
| **EE** | 4,9% | 0,3% | **AT** | 4,6% | 0,3% |
| **IE** | - | - | **PT** | 1,8% | 0,3% |
| **EL** | 2,6% | 0,3% | **SK** | 5,7% | 0,7% |
| **ES** | 2,6% | 0,7% | **SI** | 5,5% | 0,5% |
| **FR** | 2,3% | 0,7% | **FI** | 2,2% | 0,3% |
| **HR** | 5,1% | 0,3% | **BG** | 4,6% | 0,5% |
| **IT** | 1,3% | 0,7% | **CZ** | 6,0% | 0,5% |
| **CY** | - | - | **DK** | - | - |
| **LV** | 3,0% | 0,5% | **HU** | 4,4% | 0,5% |
| **LT** | - | - | **PL** | 7,8% | 0,5% |
| **LU** | 4,8% | 0,3% | **SE** | - | - |

*Source: Council 2023 CSRs*

**Box 2: Some key messages by the European Fiscal Board on the 2024 euro area fiscal stance**

*Based on unchanged policies, the European Commission actually projects in its fiscal CSRs a reduction in discretionary fiscal support for the euro area of 0.8% of GDP in 2024. Of note, the expected phase-out of energy support measures alone would amount to close to 1.25 % of GDP.*

*Because of the favourable macroeconomic outlook, the EFB considers a restrictive fiscal impulse in the euro area appropriate in 2024. Moreover, falling inflation and rising interest rates will in due time provide less relief to public finances. Barring new negative developments, an improvement in the structural primary balance beyond the 0.8% of GDP projected by the Commission would appear to be appropriate.*

*Fiscal consolidation remains particularly important for high-debt countries, which should make use of the beneficial excess of nominal output growth over implicit interest rates on government debt. In this light, the balance of Member States' contributions to the fiscal impulse in 2024 could be improved.*

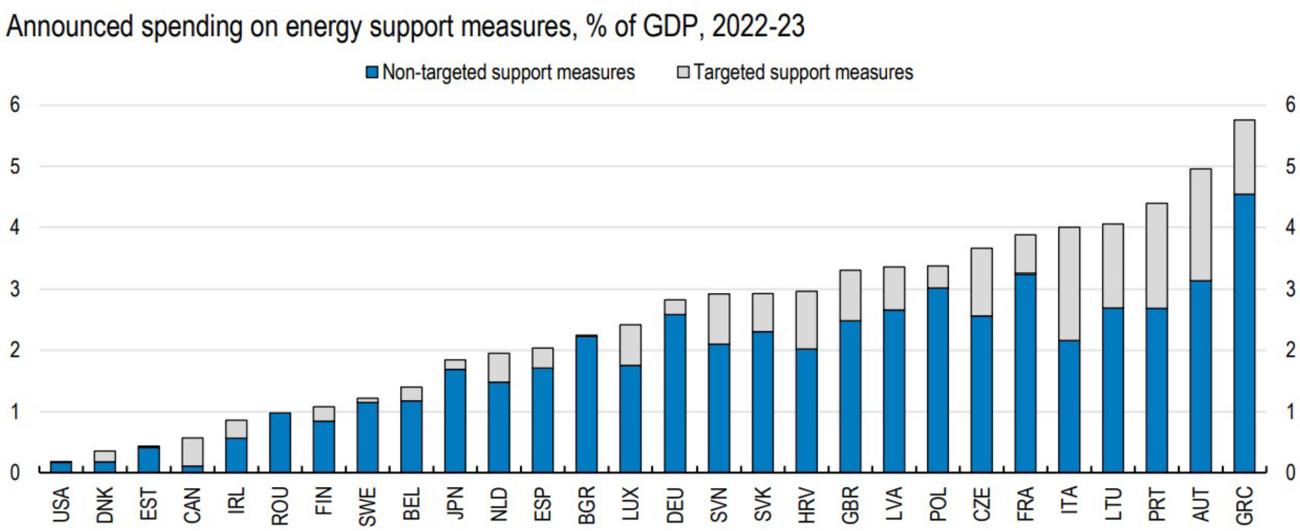
*A sizeable restrictive fiscal impulse would help the ECB in the pursuit of its inflation target. A fiscal policy stance that is too expansionary would imply higher interest rates with a potential knock-on effect on output and other macroeconomic variables.*

## Winding down of the temporary energy support measures

The Commission recommended to the Council that **all Member States wind down the energy support measures in force by the end of 2023**. However, the Council slightly deviated from this and agreed instead that in **absence of new energy shocks, support measures should wind down only in 2023-2024** (see this EGOV document).

As regards the winding down of temporary fiscal support measures related to the increase in energy prices, one may note that also the OECD has recently concluded that the **fiscal support to cushion the impact of high energy costs has been high and mostly untargeted**. Support to energy consumers amounted to more than 2% of GDP in some EU countries, well above the 0.7% of GDP in the median OECD economy. However, non-targeted income support measures, such as private transportation subsidies for employees driving to work, are not infrequent. OECD concludes that there is a strong case for gradually withdrawing broad fiscal support.

**Figure 5:** Fiscal support measures in EU in 2022-2023




*Source: OECD.*

## 3.3 Macro-economic imbalances

**On 14 July, the Council (ECOFIN) adopted conclusions on the 2023 in-depth reviews under the macroeconomic imbalance procedure**. Despite challenges such as Russia's invasion of Ukraine, high energy prices and inflation, the EU's economy has shown resilience due to swift policy actions and investment support.

**Key points include** emphasizing the importance of **timely implementation of the RRF** to support economic expansion and reduce vulnerabilities. The Council acknowledges that some Member States face **challenges** related to inflation, debt levels and import prices of energy. It also recognizes the need for vigilance in preventing these imbalances and addressing structural challenges (e.g., ageing population and climate change). In addition, **the Council welcomes the publication of the 2023 in-depth reviews and the early thematic notes on the inflation differentials, house prices and external sustainability**.

**It highlights the importance of MIP within the European Semester and calls for its continued implementation and enhancement.** It acknowledges that the analysis in the Macroeconomic Imbalance Procedure should be developed to enhance the euro area dimension of the procedure. The MIP should be used to its full potential, including the activation of the EIP when appropriate by maintaining transparency and equal treatment. Continued policy action to reduce imbalances that is aligned with country-specific recommendations is called for.

According the latest in-depth reviews by the Commission in May 2023, vulnerabilities mainly stem from the uncertainty related to high inflation, which can negatively impact competitiveness, tighten financial conditions potentially triggering price corrections notably in the housing market and lead to adverse distributional consequences.

Against this background, the latest country specific findings by the Commission are as follows:

*Member States **experiencing excessive imbalances**:*

- ***Greece*** has excessive imbalances and continues to face vulnerabilities related to high government debt and non-performing loans. While the government debt-to-GDP ratio has improved and has resumed declining path following COVID-19 crisis (but remains the highest in the EU standing at 171%), non-performing loans remain high and weigh on banks' profitability and lending capacity. Further efforts are needed to improve external (im)balances and reduce non-performing loans. The implementation of the RRP presents an opportunity to address remaining structural weaknesses.
- ***Italy*** has consistently exhibited excessive imbalances since 2014, with vulnerabilities related to high government debt reaching 144.4% of GDP and weak productivity growth persisting despite some improvements. Low productivity growth has impacted banks' balance sheets and slowed down government debt deleveraging. The government has implemented measures to support the financial sector, and non-performing loans have significantly declined, but banks are still exposed to the sovereign. The implementation of the RRP is a key policy priority to raise competitiveness and productivity levels, but country is faced with challenges so additional efforts are needed in taxation, fiscal framework, pension systems, demography, labour market, and

*Member States experiencing Imbalances:*

- ***Cyprus***: After facing excessive imbalances until 2022, Cyprus is currently experiencing imbalances. Although vulnerabilities related to private, government, and external debt have decreased, they still remain a concern.
- ***Hungary***: Imbalances have emerged in Hungary especially in relation to high inflation and external and government financing needs, and there is a risk that they may become excessive in the future if

urgent policy actions are not taken. The overall outlook is tilted towards the downside.

- ➢ ***Germany, Spain, France, the Netherlands, Portugal, and Sweden***: These countries continue to experience imbalances. However, in Germany, Spain, France, and Portugal, vulnerabilities are diminishing to the extent that if these positive trends continue next year, a decision of no imbalances may be reached.
- ➢ ***Romania****:* Among the countries with imbalances, Romania faces downside risks, and imbalances may become excessive in the future if immediate policy actions are not implemented.

***Czechia, Estonia, Latvia, Lithuania, Luxembourg,* and *Slovakia*** are not found to be experiencing imbalances as vulnerabilities seem overall to be contained at present.

The next Alert Mechanism Report with MIP scoreboard indicators will be published in November 2023 at the start of the European Semester 2024

## 4. Completing the Economic and Monetary Union

### 4.1 EU economic governance reform

On 26 April, the Commission presented its **legislative proposals for the EU economic governance reform**.

The reform proposals by the Commission comprises of three legal texts:

- Proposal to repeal and replace the current preventive arm of the Stability and Growth Pact ;
- Proposal amending the Regulation on the corrective arm of the Stability and Growth Pact ; and
- Proposal amending the Directive on the requirements for budgetary frameworks of Member States

These legal texts propose *de facto* amendments that would also affect the application of some of the other EU economic governance legal acts in force today[7].

At the end of its term, the Swedish Presidency of the EU highlighted that "*Concrete progress has been made on the economic governance review through the approval of Council conclusions on the direction of reform of the framework, which formed the basis for the European Commission's legislative proposals that were presented in April. The Presidency has worked intensively on the proposals, with a discussion held at the ministerial level in June*."

Based on discussions at Council level, key issues identified to frame the Council general approach are centred on **four building blocks**:

- ➢ Institutional balance
- ➢ Common safeguards
- ➢ Fiscal space for investments and incentives for reforms
- ➢ Credible enforcement and ownership

The Spanish Presidency has included in the draft agenda of the **ECOFIN meeting of 9 November as an agenda point a general approach on the economic governance review files**

**Work is ongoing in the European Parliament on the review of the economic governance framework**. Formally, the EP has only a role as co-legislators for the preventive arm proposal (ordinary legislative procedures) while it will be consulted on the other two proposals.

[7] The Proposal to repeal and replace the current preventive arm of the SGP has a connection with Regulation No 1176/2011 to prevent and correct macroeconomic imbalances: if a Member State does not fulfil its commitments regarding reforms and investments outlined in its medium-term fiscal-structural plan to address the CSRs relevant to the Macroeconomic Imbalances Procedure, the Council may issue a recommendation declaring that an excessive imbalance exists. Moreover, when providing an opinion on the draft budgetary plans submitted pursuant to Article 6 of Regulation No 473/2013, the Commission should assess if the DBPs are consistent with the net expenditure paths pursuant to this proposal.

Over the summer, the EP has also finalised the allocation of competences for the files. The ECON committee is the lead committee for the three proposals whereas the Committee on Employment and Social Affairs (EMPL) has been appointed for an opinion on the preventive arm proposal based on its areas of competence (e.g. European Pillar of Social Rights in the context of the European Semester). The EMPL opinion is scheduled for adoption in the Committee on 25 October 2023. A public hearing on the reform of the economic governance review in ECON is currently scheduled on 20 September in the ECON Committee.

**Box 3: Published Member States' positions**

- ***In April 2022, Spain and the Netherlands published a joint paper on "priority issues in 2022 on the EU's economic and financial policy agenda".*** *It highlights in particular that a renewed EU Fiscal Framework should help to deliver on the core objective of reinforcing fiscal sustainability in a more effective and efficient manner, while taking into account the sizeable investments effort needed to honour ambitious commitments, particularly for green and digital transitions. It also suggests that national governments should propose medium-term fiscal plans to ensure fiscal sustainability in a growth-friendly manner and credible reform commitments. The joint paper also suggests transforming medium-term objectives into a simpler expenditure rule to enhance comprehensibility and enforceability. Strengthening national fiscal frameworks and involving Independent Fiscal Institutions can help increase transparency and compliance with fiscal rules.*
- ***On 15 June 2023, eleven EU Finance Ministers, led by the German Finance Minister, published a joint article*** *emphasising the need for a reform of the European economic governance framework to effectively reduce the public debt that has accumulated in the Eurozone in recent years due to the Covid-19 pandemic and energy crisis.* ***The ministers suggest that the reform of the SGP should establish reliable, transparent, easily measurable, and binding budgetary rules with quantitative criteria that apply to all EU countries to promote budget consolidation and growth****. They caution against making reform and spending decisions too far in advance in the context of an uncertain environment and emphasise the need to preserve the right balance between the powers of the European Commission and the Member States.*

**Box 4: Core elements of the Commission's proposal for review of the economic governance framework**

The proposals of the European Commission aim at striking a balance between reductions of debt levels and supporting sustainable growth, while promoting national ownership, improving enforcement and simplifying the rules. The proposals pivot around a number of key elements:

- **Country-specific fiscal adjustment**: Depending on levels of public indebtedness, as measured by the Maastricht reference values of debt above 60% of GDP and deficit above 3% of GDP, the Commission would propose technical trajectories for debt/deficit reduction. After bilateral discussions with the Commission and endorsement in Council, each Member State would adopt country-specific medium-term fiscal-structural adjustment plans (MTFSP) outlining numerical targets to be achieved by the end of the assessment period.
- **Medium-term focus:** The minimum length of the MTFSP would be four years, but could be extended by three more years to achieve a more gradual debt reduction subject to the commitment to investment and reform programmes. Changes in government would allow for a revision as long as this does not lead to lower ambition in the fiscal adjustment effort or back loading. The Commission also envisages a certain degree of flexibility by codifying the existence of two escape clauses and regulate their use.
- **Shift towards more observable indicators:** Compliance would be monitored only through net public expenditure targets. The Commission would establish a control account to track cumulative deviations from the expenditure path while Member States would be obliged to report annually on their plans.
- **More automaticity for debt-based excessive deficit procedures (EDPs):** This would allow to replace the current 1/20th annual debt reduction rule. The degree of debt challenge for a Member State would become a key relevant factor to assess when considering the launch of an EDP.
- **Safeguards:** A number of safeguards are proposed to ensure that debt ratios fall below their initial level at the end of the period, that fiscal adjustment is at least 0.5% of GDP per year for deficits (expected to be) in excess of 3% of GDP, that in case of extensions most of the fiscal adjustment is delivered in the first four years and prevent back-loading / lowering of fiscal adjustment efforts.

**Further reading:** EGOV briefing on *Enhanced political ownership and transparency of the EU economic governance framework*

## 4.2 Completion of the Banking Union

In 2016, ECOFIN agreed a roadmap to complete the Banking Union. Work towards a European Deposit Insurance System (EDIS) was an integral part of it. In spring of 2022, there had even been some hope that discussions in the Eurogroup would break the deadlock among Member States by agreeing a way forward on the open issues of the Council's roadmap, EDIS and sovereign exposures. This did not happen; instead, ECOFIN endorsed a request to the Commission for **proposals to improve bank crisis management**.

In this briefing of January 2023, we provided an overview of that request. In short: clarifying and harmonising the public interest assessment so that resolution to applies more widely; harmonising the use of national deposit guarantee schemes in resolution maintaining appropriate flexibility for market exit of failing banks; harmonising national bank insolvency laws to a limited extent.

Meanwhile the **European Parliament** published its 2022 Banking Union report. The Parliament expressed its **regret that the BU is still incomplete** without a European Deposit Guarantee Scheme and recalled that it is ready to resume work to complete it as soon as possible. As to the Commission's impending proposal improving crisis management, the report expressed the hope it could help **overcome hurdles to the completion of the Banking Union**.[8] Specifically, the report called for:

- **addressing the loopholes** in the crisis management framework;

[8] The ECON Committee has commissioned contributions from its banking expert panel as to how a reform of the crisis management framework could support completion of the banking union.

- further specification and harmonisation of the **public interest assessment**;
- greater harmonisation of the **treatment of small and medium-size banks**;
- **appropriate financial resources** excluding taxpayers' money, accompanying the resolution tools;
- **level playing field** among different banking group structures; and
- consistency of the resolution framework and the **State aid rules**.

After a number of delays, the **Commission's proposal** for reforms of the crisis management and deposit insurance (CMDI) has arrived in April 2023. The proposal's central elements are:

Tightening of the criteria for **public support to banks outside resolution**;

A **new phase of involvement of the resolution authority with a bank** that precedes resolution. It is triggered when the supervisor sees a "*material risk*" of the bank becoming failing or likely to fail. Please see the last section of this briefing for additional detail and some initial thoughts on possible implications;

Modifications of the public interest assessment that are intended to **ensure resolution is chosen more often**. We consider these modifications in more detail here;

A modification of the insolvency ranking of deposits. Basically, all deposits are supposed to enjoy a privileged ranking, which does not distinguish anymore between deposits covered by the deposit guarantee schemes directive and those that are not. While this measure leaves the coverage by the deposit guarantee untouched, it aligns the incentives of the deposit guarantee scheme with those of uncovered depositors. By consequence, the Commission hopes that the deposit guarantee scheme will be more likely to fund resolution measures which then eventually (1) improves the likelihood of avoiding losses for all depositors and (2) facilitates the resolution of banks that are predominantly deposit-funded;

Some **extensions of deposit guarantee coverage in the margins**, while leaving the general limit of 100.000 Euro in place. However, **general depositor protection is proposed to become a public interest objective** that resolution authorities will have to pursue, likely avoiding losses for uninsured depositors in many cases, as discussed in this briefing.

**Council has started examining the proposals** at working group level. ECFIN has legislative deliberations about a general approach currently scheduled for November 9, 2023. On the EP side, a first exchange of views in ECON is scheduled for September 20.

*Further reading:*

- Bank crisis management and deposit insurance
- A revised public interest test for bank resolution, how much will it matter?
- CMDI reform: What are the implications for depositors?

## 4.3 Progress of the Capital Markets Union

The Capital Markets Union (CMU) project, put forward by the Commission in 2015, is pursued by the EU to put finance for the economy onto stronger and broader foundations. Since, there have been numerous legislative initiatives and follow-up communications from the Commission, yet among finance ministers there are concerns that **EU capital markets have still not caught up with international peers**.

On 28 April 2023, representatives of the European Parliament, the current and incoming (i.e., the Spanish) presidencies of the Council of the EU, and the Commission committed to **finalising pending CMU initiatives as quickly as possible**, in any case before the end of the current legislative cycle; see **Box 1** on page 2 for a list of ongoing and pending legislative procedures. CMU-relevant are: clearing package, listing package, retail investment package and ESG ratings and in some respects (capital markets investments by insurers) also Solvency 2. Of these, retail investments and ESG rating appear on the ECOFIN agenda on 8 December for legislative deliberations about a general approach. There is a general approach on the listings package since June, Solvency 2 is in trilogies and we have no news on the clearing package.

In addition, the Eurogroup (even though CMU is not a euro zone project) agreed on an initiative to identify **additional areas in which further progress is "possible and likely" in the years ahead** - beyond the topics that are already on the legislative agenda. See also their work program. The Eurogroup talks of a "strategic reflection" and intends to ask the next Commission to consider the areas identified. We understand the Eurogroup will report in May 2024 to ECFIN, so under the following presidency.



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