

Economic governance: prevention and correction of macroeconomic imbalances. 'Six pack'

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The Commission presents its Alert Mechanism Report, which is prepared in accordance with Articles 3 and 4 of the Regulation No 1176/2011 of the European Parliament and of the Council on the prevention and correction of macro-economic imbalances. This marks the first step in implementing the new surveillance procedure for the prevention and correction of macroeconomic imbalances (the Macroeconomic Imbalance Procedure – MIP). The report also contains the final design of the scoreboard of indicators.

Surveillance to prevent and correct macroeconomic imbalances under the MIP is a new instrument of the strengthened framework for economic governance in the EU. It was adopted as part of the 'six-pack' governance package, which also provides for a significant reinforcement of surveillance on fiscal policies.

The Scoreboard: the scoreboard has been established by the Commission and is made up of ten indicators with a view to monitor external imbalances, competitiveness and internal imbalances, including housing markets and indebtedness.

Currently, the design of the scoreboard is as follows:

External imbalances and competitiveness

- 3 year average of the current account balance as a percentage of GDP, with a threshold of +6% and - 4% of GDP;
- net international investment position (NIIP) as a percentage of GDP, with a threshold of -35%; the NIIP shows the difference between a country's external financial assets and its external financial liabilities;
- 5 year percentage change of export market shares measured in values, with a threshold of -6%;
- 3 year percentage change in nominal unit labour cost (ULC), with thresholds of +9% for euro area countries and +12% for non-euro area countries;
- 3 year percentage change of the real effective exchange rates (REER) based on HICP deflators, relative to 35 other industrial countries, with thresholds of -/+5% for euro-area countries and -/+11% for non-euro-area countries; the REER shows price competitiveness relative to the main trading partners.

Internal imbalances

- private sector debt as a percentage of GDP with a threshold of 160%;
- private sector credit flow as a percentage of GDP with a threshold of 15%;
- year-on-year changes in deflated house prices, with a threshold of 6%;

- public sector debt as a percentage of GDP with a threshold of 60%;
- 3-year average of unemployment rate, with a threshold of 10%.

Main findings

An adjustment of macroeconomic imbalances is underway in many Member States, especially those which have/had high external deficits and large imbalances in household and/or corporate balance sheets and in their public sectors. This process still has some way to go, and has led in a number of Member States to a significant rise in unemployment levels and a reduction in the level of economic activity in the short term. Reforms promoting productivity growth will have particular relevance for Member States suffering from macroeconomic imbalances due to their positive impact on potential output and adjustment capacity. In the current environment, the risks of new demand-led imbalances emerging are generally low, although pressures on asset markets could re-emerge once growth resumes.

Countries not examined under MIP: given that programme countries are already under enhanced economic surveillance of their economic situation and policies, they are not examined under the macroeconomic imbalances procedure. This concerns **Greece, Ireland, Portugal and Romania**. Latvia is under post programme surveillance as the balance of payment assistance programme expired on 19 January 2012 and is therefore examined in this report.

Member States identified for further analysis: on the basis of the economic reading of the scoreboard, the Commission considers that further in-depth analysis is warranted to closer examine issues involving several Member States. The broad approach reflects the fact that this is the first application of surveillance under this procedure and that it therefore has to cater also for the adjustment to previously accumulated imbalances. **The Member States concerned are: Belgium, Bulgaria, Denmark, Spain, France, Italy, Cyprus, Hungary, Slovenia, Finland, Sweden and the United Kingdom.**

These Member States have different challenges and potential risks including spillover effects. Some Member States need to correct accumulated imbalances on both the internal and external side. They will have to reduce high levels of overall indebtedness and regain competitiveness so as to improve their growth prospects and export performance. In-depth analysis will help to assess the drivers of productivity, competitiveness and trade developments as well as the implications of the accumulated level of indebtedness and the degree of related imbalances in several Member States. Some countries are experiencing rapid adjustment partly due to catching-up effects and these developments may require a closer examination. Despite overall good macroeconomic performance some countries display developments in asset markets, including in particular housing, and a continuous build-up of indebtedness in the private sector, which also warrant further analysis.

Surpluses: the economic reading of the scoreboard indicators points to the need for further horizontal analysis on the drivers and policy implications of large and sustained current account surpluses, especially in some euro area Member States. The Commission notes the Member States that continue to **record persistent current account surpluses: Luxembourg and Sweden exceed the indicative threshold of 6%, while Germany and the Netherlands are just below it.** The Commission's 2011 autumn forecast points to some further narrowing of current account positions over next two years, although the reductions in deficits are likely to be mild in most cases, while in the Netherlands, for example, surpluses are set to increase.

The Commission will undertake further assessment of the divergence in economic performance across Member States, including **exploring trade and financial interlinkages between deficit and surplus countries** and examine ways for further re-balancing at the level of the euro area and within the global context. It will also assess the role played by structural factors, including the functioning of services

markets, through their impact on domestic consumption and investment, as a driver of sustained surpluses and thus pointing towards the necessary policy guidance. In this context the Commission will also study further the role played by catching-up effects.

In the context of multilateral surveillance, the Commission invites the Council and the Euro Group to discuss this report. The Commission is also looking forward to feedback from the European Parliament and other stakeholders.