Focus

I. The surveillance of macroeconomic imbalances in the euro area

In the first decade of the euro's existence, many euro-area countries witnessed a build-up of macroeconomic imbalances. These vulnerabilities proved to be highly damaging once the financial crisis set in. The ongoing unwinding of the accumulated macroeconomic imbalances is a protracted process and the adjustment is proving to be particularly painful in terms of growth and employment. Against this background, the recently adopted Macroeconomic Imbalance Procedure (MIP) broadens the EU economic governance framework to include the surveillance of unsustainable macroeconomic trends. The aim of the MIP is to identify potential risks early on, prevent the emergence of harmful imbalances and correct the excessive imbalances that are already in place. It has a broad scope and encompasses both external imbalances (including competitiveness trends) and internal imbalances. While the design of the MIP builds on experience gained from the recent crisis, it is flexible enough to take on board new trends and developments as potential future crises may have different origins. Its objective is to ensure that appropriate policy responses are adopted in Member States in a timely manner to address the pressing issues raised by macroeconomic imbalances. In doing so, the MIP relies on a graduated approach that reflects the gravity of imbalances and can eventually lead to the imposition of sanctions on euro-area members should they repeatedly fail to meet their obligations. Implementation of the MIP started with the Commission publishing in February its first Alert Mechanism Report, which identifies a group of Member States for which more in-depth analysis is warranted. Following the completion of these in-depth reviews, policy guidance will be issued where appropriate and further steps decided.

I.1. Introduction

The unravelling of the economic and financial crisis of recent years has laid bare some weaknesses in the surveillance arrangements within EMU and the framework for coordinating economic policies in general. In particular, the build-up of macroeconomic imbalances in pre-crisis years was not checked sufficiently and their unwinding has since proven very costly for some euro-area countries and has also contributed to the ongoing sovereign debt crisis, with serious implications for the functioning of the euro area as a whole.

These developments show the need to broaden the economic governance framework underpinning EMU so as to include the issue of unsustainable macroeconomic trends. The new procedure for the prevention and correction of macroeconomic imbalances — the Macroeconomic Imbalance Procedure (MIP) — responds to this need and was one of the key building blocks of the legislative package (the 'six-pack') to enhance the governance structures in EMU. ([1]) This focus section describes further the economic rationale of the MIP, how it will work and the state of play, given that it is currently being applied for the first time in the context of the 2012 European Semester.

([1]) Besides the Regulations introducing the MIP, the 'six-pack' includes enhancements in the Stability and Growth Pact and national fiscal frameworks. It has been in place since December 2011.

I.2. Macroeconomic imbalances in the euro area

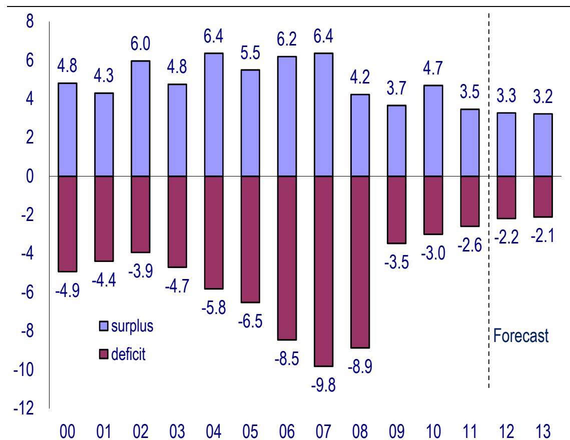
One of the salient features of the first decade of the euro area's existence was the gradual accumulation of macroeconomic imbalances. Perhaps the most visible manifestation of such imbalances was the increasing divergence in external positions. Some Member States saw their current account deficit rise to staggering levels while others accumulated substantial current account surpluses (Graph I.1).

The mounting current account deficits and surpluses were a counterpart to strong capital flows across the euro-area members. These were boosted by the establishment of the euro and progress in financial market integration in the euro area.

Capital inflows benefited mostly those Member States which in the run-up to EMU experienced the largest reductions in nominal interest rates and where the real returns on investment appeared the highest.

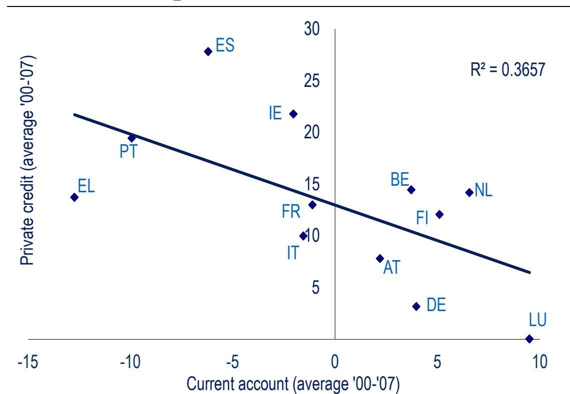
While the observed developments partially reflected sound catching-up processes, particularly in the initial period, they also had much less benign repercussions and became a significant ingredient of unsustainable macroeconomic trends in some countries. Part of the capital flows was channelled into unproductive uses and fuelled domestic demand

Graph I.1: **Current account positions in the euro area, % of GDP (1)**



(1) Surplus countries: BE, DK, DE, LU, NL, AT, FI and SE. Deficit countries: BG, CZ, EE, IE, EL, ES, FR, IT, CY, LV, LT, HU, MT, PL, PT, RO, SI, SK and UK. Surplus/deficit countries grouped on the basis of average current account positions between 2000 and 2010.
Source: Commission services

Graph I.2: **Private credit growth and current account positions, % (2000 - 2007) (1)**

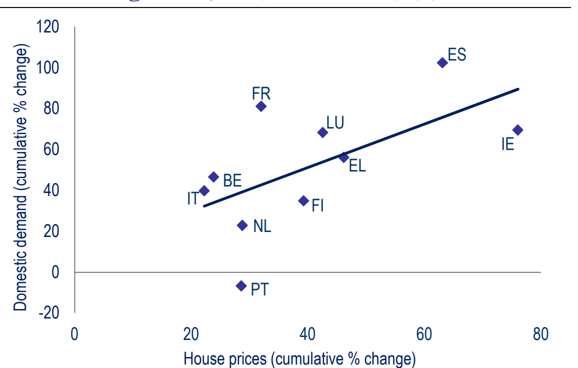


(1) Note: Average private credit (transactions) as % of GDP and average current account over 2000-2007.
Source: Commission services

booms, which were associated with excessive credit expansions in the private and/or public sectors and housing bubbles in some euro-area members. The links between external imbalances and imbalances building up in domestic sectors of euro-area economies can be seen in Graph I.2, which shows that the excessive credit expansions stimulated demand and pushed current accounts into deep deficits in some Member States. In particular, countries such as Greece, Spain or Ireland experienced rather fast rates of growth that were to a large degree driven by domestic demand booms and, with the exception of Greece, housing booms and expansions in the construction sectors (Graph I.3).

The expansion of domestic demand generated upward pressure on prices, which was particularly strong in non-tradable sectors. The resulting changes in relative prices induced a reallocation of resources in the economy towards the non-tradable sectors and, on the whole, resulted in substantial losses in price and cost competitiveness. This can be clearly seen from the developments in competitiveness indicators, such as real effective exchange rates or unit labour costs, which document the increasing divergences in the euro area. Faced with strong demand pressures, some countries were also unable to react appropriately to negative productivity shocks.

Graph I.3: **Domestic demand and house price growth, % (2000 - 2007) (1)**



(1) Certain Member States are omitted due to lack of data availability.
Source: Commission services

Moreover, some euro-area countries have shown a worrying gradual deterioration in export market shares. Changes in shares of world export markets for goods and services point to potentially large structural losses in overall competitiveness in the global economy. In some countries, this may reflect the already discussed losses in price/cost competitiveness or the diversion of resources to the non-tradable sector during domestic absorption booms, but an important role also seems to be played by relative losses in non-price competitiveness and low ability to exploit new sales opportunities. As a result, the export performance of some euro-area countries has been lagging behind not only the dynamic global competitors such as China but also other euro-area peers.

Conversely, domestic demand in other Member States appears to have been constrained, in part, due to existing rigidities in product markets. This, together with mispricing of risk in financial markets and the related outflows of capital, resulted in growing current account surpluses.

When the crisis struck, the existence of large imbalances proved highly damaging: their unwinding contributed, particularly in the euro area, to the gravity and propagation of the crisis in a number of Member States by deepening the contraction as well as aggravating the situation of public finances. Implicit or explicit government guarantees for the troubled banking sector resulted in the transfer of risk from private to public sector. Additionally, sharp contractions in the overblown sectors, e.g. construction, and the related increases in unemployment contributed to the deterioration of public finances through falling tax revenues and increased unemployment support. Moreover, the sovereign debt crisis that hit Greece, Ireland and Portugal generated strong cross-border spillover effects through the loss of confidence by financial markets. This underlines the need for an EU/euro area-wide approach to the surveillance of imbalances.

While current account positions have converged to some extent since the onset of the crisis, there is still considerable scope for adjustment and rebalancing in the euro area. In particular, the large accumulated stocks of debt will require prolonged repair of balance sheets in both public and private sectors. Moreover, some of the most affected countries still run non-negligible current account deficits that point to the need for external financing, which is difficult to secure given the distress in financial markets. ([2]) Finally, more pronounced relative price adjustment than experienced so far is necessary to ensure that the corrections in external imbalances prove to be lasting and not associated with the build-up of persistent internal imbalances such as a high rate of structural unemployment.

I.3. The MIP as a tool to tackle macroeconomic imbalances

In view of these hard-learned lessons, the MIP has been conceived to identify potential risks early on, prevent the emergence of harmful imbalances and correct the excessive imbalances that are already in place. Its objective is to ensure that appropriate policy responses are adopted in Member States to address the pressing issues raised by macroeconomic imbalances.

Today, it is relatively straightforward to see that in the years preceding the crisis, low financing costs and other factors fuelled a misallocation of resources, often to less productive uses, feeding unsustainable levels of consumption, housing bubbles and the accumulation of external and internal debt. Indeed, previous Commission analysis did identify imbalances in several areas of the EU/euro-area economies. ([3]) However, at the time, the policy discussions and responses were not systematic and lacked teeth.

As regards the policy responses, alongside sound fiscal policies and appropriate financial regulation, growth-enhancing structural policies are key to addressing the issue of macroeconomic imbalances. Such policies help stimulate the supply side of the economy, increase competitiveness and improve adjustment capacity — this is essential in countries experiencing external deficits. Such policies can mitigate the adverse growth effects of the deleveraging. At the same time, they boost domestic demand to the extent that it is constrained by market and policy failures — this is relevant for surplus countries with anaemic domestic demand.

Nevertheless, there are significant analytical challenges involved in the identification of excessive imbalances that are also reflected in the design of the procedure.

Most importantly, macroeconomic imbalances are part of everyday reality and in many cases they can be justified by the underlying economic developments. For example, external imbalances do not necessarily need to be worrisome if deficits/surpluses are efficient market-based responses to changes in underlying fundamentals and the related saving and investment decisions of households or businesses. Similarly, 'downhill' capital flows from rich to less well-off countries are usually seen as a positive development that facilitates economic convergence as they help catching-up countries cover their domestic financing gaps. To the extent that capital inflows are used for building up productive capacity, they boost future growth prospects and the ability to repay the borrowed capital. However, if they become excessive and are driven by policy or market failures, they can have dire repercussions.

This also reflects the fact that imbalances are a result of complex economic interactions involving

([2]) See also the special topic on capital flows in this Quarterly Report.

([3]) For example, in the framework of the Commission's review of competitiveness developments and imbalances, informal surveillance in the Eurogroup and assessments in the context of the Stability and Growth Pact and the Lisbon strategy. An overview of the Commission's analysis can be found in the special issue of the Quarterly Report on the Euro Area on 'The impact of the global crisis on competitiveness and current account divergences in the euro area', Volume 9 No 1 (2010).

different sectors within as well as outside the national economy. Consequently, the underlying indicators of imbalances cannot be seen as policy objectives as they are not under the direct influence of policy-makers (unlike in the case of fiscal policy).

What is more, the nature of imbalances can change over time and past experience can give only limited guidance on how and where they are likely to appear.

I.4. How the MIP works

The overall design of the Macroeconomic Imbalance Procedure follows the implicit logic of the Stability and Growth Pact, with a 'preventive' arm and a stronger 'corrective' arm for more serious cases. For euro-area countries, the corrective arm is supplemented by an enforcement mechanism including the possibility of financial sanctions. ([4])

I.4.1. The preventive arm and the alert mechanism

To detect macroeconomic imbalances, the procedure relies on a two-step approach. The first step consists of an alert mechanism aiming to identify Member States where there are signs of potentially emerging macroeconomic imbalances and which therefore require more in-depth examination. In the second step, the in-depth reviews undertaken for the identified Member States assess whether there are imbalances and, if so, their nature and extent.

The objective of the alert mechanism is to identify macroeconomic imbalances as soon as they emerge so that necessary policy actions can be taken in due time to prevent them from becoming damaging for the Member State concerned and from jeopardising the functioning of the euro area. More specifically, the alert mechanism consists of an indicator-based scoreboard (presented in detail in the next section) together with an economic reading thereof, presented in an annual Alert Mechanism Report (AMR). It should be stressed that the scoreboard is just one component of the alert mechanism, and additional relevant indicators, economic circumstances and country-specific situations are taken into account.

The alert mechanism is an initial 'filter' where the outcome is to identify countries and issues for which more in-depth analysis is required. The conclusions of the AMR are discussed in the Council and the Eurogroup to enable the Commission to obtain appropriate feedback from Member States. The Commission then decides on the final list of countries for which it will prepare country-specific in-depth reviews.

It is only the in-depth reviews that lead to eventual policy guidance to be issued to Member States. The reviews will undertake thorough analysis of the macroeconomic imbalances, in particularly as regards their nature and extent, taking into account the economic and structural specificities of the Member State considered.

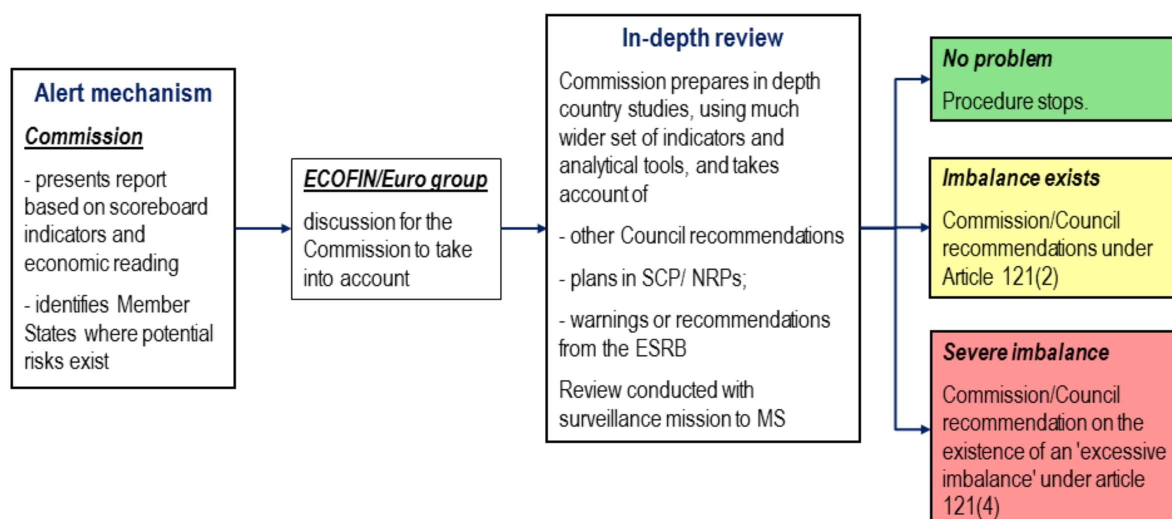
If, on the basis of this analysis, the Commission considers the situation unproblematic it will conclude that no further steps are needed. If, however, the Commission considers that macroeconomic imbalances exist, it may come forward with proposals for policy recommendations for the Member State(s) concerned. In the preventive arm, these will be part of the integrated package of recommendations under the European Semester. This is particularly important since policy remedies to address imbalances cover to a very large extent policies (e.g. labour market, product market and fiscal policies) that may also be subject to other surveillance processes. If the Commission instead considers that there are severe imbalances, it may recommend that the Council open an excessive imbalance procedure, which constitutes the corrective arm of the new procedure. Graph I.4 sums up the entire process graphically.

I.4.2. The corrective arm and effective enforcement

As mentioned above, the corrective arm includes an enforcement dimension that applies only to euro-area Member States. While decisions are normally taken in the Council by qualified majority voting, in this procedure several of the key Council decisions are taken by reverse qualified majority voting (RQMV). In the case of RQMV, a novelty for many of the key enforcement decisions across the 'six-pack', a

([4]) The Macroeconomic Imbalance Procedure rests on two pieces of legislation. The first Regulation (EU 1176/2011) sets out the details of the new surveillance procedure and covers all the Member States. The second Regulation (EU 1174/2011) establishes the enforcement mechanism, including the potential use of sanctions, and only applies to the euro-area Member States.

Graph I.4: **The two-step MIP procedure**



Source: Commission services

Council decision on a Commission recommendation is deemed to be adopted by the Council unless it decides, by qualified majority, to reject the recommendation within ten days of the Commission adopting it. The aim of this voting rule is to increase the automaticity of the decision-making process.

If the in-depth review points to severe imbalances in a Member State, the Council declares the existence of an excessive imbalance and adopts a recommendation asking the Member State to present corrective actions by a specified deadline. Then, and this is a key feature of this new procedure, the Member State has to present a corrective action plan (CAP) setting up a roadmap to implement corrective policy actions. The CAP should be a detailed plan for corrective actions with specific policy actions and an implementation timetable. This timetable and the follow-up will be tailored to the country-specific situation and can thus depart from the European Semester cycle.

As regards the content of the CAP it is clear that the policy response to the macroeconomic imbalances has to be tailored to the circumstances of the Member State concerned and where needed will cover the main policy areas, including fiscal and wage policies, labour markets, product and services markets and the financial sector. Moreover, efficiency and credibility depend on consistent approaches across policy strands. As described above, to this end consistency must be ensured with the policy advice given in the context of the European Semester.

After the Member State has submitted its CAP, the Council assesses it with two possible outcomes:

- If the Council considers the CAP to be insufficient, it adopts a recommendation to the Member State calling on it to submit a new CAP. If the new CAP is still considered to be insufficient, a fine can be imposed (by RQMV, see below) for having failed twice in a row to submit a sufficient CAP (0.1 % of GDP). Thus the Member State cannot stall the procedure by not presenting a satisfactory CAP.

- If the Council considers the CAP to be sufficient, it will endorse the CAP through a recommendation that lists the corrective actions and their implementation deadlines.

Once a sufficient CAP is in place, the Council will then assess whether or not the Member State concerned has taken the recommended actions according to the deadlines set. Two outcomes are possible:

- If the Council considers that the Member State concerned has not taken the recommended corrective action, it will adopt a decision establishing non-compliance together with a recommendation setting new deadlines for taking corrective action. In this case, the enforcement regime established by the Regulation comes into play. It consists of a two-step approach. In case non-compliance with the issued recommendation is established for the first time, the Council may impose an

interesting-bearing deposit (0.1 % of GDP). Once the Council establishes non-compliance for a second time, it can convert the deposit into an annual fine. These decisions are taken by RQMV.

- If the Council decides, on the basis of a Commission recommendation, that the Member State concerned has taken the recommended corrective action, but imbalances are not yet corrected, the procedure will be placed in abeyance. The Member State continues to be subject to periodic reporting. If the Council considers that the Member State concerned has taken the appropriate action and the Member State is no longer experiencing excessive imbalances, the EIP will finally be closed.

I.5. The role and design of the MIP scoreboard

The scoreboard is an important component of the alert mechanism and is intended to facilitate the identification of trends that require closer examination. As mentioned above, it is not interpreted mechanically and economic judgment is employed when interpreting its results.

The indicators that are included in the scoreboard cover the most relevant areas of imbalances that are under the scope of the MIP. In line with the different challenges faced by the EU/euro-area countries, it comprises indicators of external positions (current account and net international investment position), competitiveness developments (real effective exchange rates, unit labour cost, export market shares) and indicators of internal imbalances (private sector and general government debt, private sector credit flow, house prices and the unemployment rate). The scoreboard thus encompasses variables that both the economic literature and recent experience establish as being linked to economic crises.

This broad coverage of the scoreboard makes it possible to take into account the versatile nature of imbalances and their close interlinkages. As discussed above, the developments in external imbalances are typically intrinsically linked to internal developments (e.g. the domestic counterpart to excessive external debt is excessive private or public debt). In such a case, internal indicators show whether risks associated with external imbalances are concentrated in specific sectors of the economy. In some cases, individual indicators on their own can point to specific risks that need to be addressed. In particular, some internal imbalances can have repercussions for other Member States via financial contagion.

For the sake of transparency and easy communication, the scoreboard contains a limited number of simple indicators of high statistical quality. It combines stock and flow indicators that can capture both shorter-term rapid deteriorations and the longer-term gradual accumulation of imbalances.

To facilitate the use of the scoreboard, indicative thresholds have been set for each indicator. These thresholds are mostly based on a simple statistical approach and are set at lower and/or upper quartiles of the historical distributions of the indicator values. These statistically determined thresholds are broadly in line with the findings of economic literature on the early-warning properties of different indicators in terms of predicting economic and financial crises. The breach of the indicative thresholds does not automatically trigger an ‘alarm’ in the form of a requirement for an in-depth review, though. Only the comprehensive economic reading of the result of the scoreboard, which takes into account additional information, indicates a need for further analysis.

The scoreboard takes into account the euro-area dimension and differentiates between euro-area and non-euro area Member States where appropriate. Due to differences in exchange rate regimes, the behaviour of some economic variables in the euro area is different from the non-euro area countries. This argues in favour of using different alert thresholds for euro-area and non-euro area Member States for indicators such as REERs and ULC developments. With respect to REERs, a differentiation in the indicative thresholds reflects greater nominal exchange rate variability in the non-euro area countries. For ULC, an additional margin was added to the indicative threshold for non-euro area countries because most of them have experienced major trade liberalisation since the mid-1990s that entails a natural process of factor price equalisation towards the levels of trade partners. These strong adjustment processes due to trade liberalisation should, however, be considered weaker in the future and the threshold reassessed.

At present, the scoreboard includes ten indicators: ([5])

- three-year backward moving average of the **current account balance** in per cent of GDP, with a threshold of +6 % and -4 %;
- **net international investment position** in per cent of GDP, with a threshold of -35 %;
- five-year percentage change of **export market shares** measured in values, with a threshold of -6 %;
- three-year percentage change in **nominal unit labour cost** (ULC), with thresholds of +9 % for euro-area countries and +12 % for non-euro area countries respectively;
- three-year percentage change of the **real effective exchange rates** (REERs) based on HICP/CPI deflators, relative to 35 other industrial countries, with thresholds of -/+5 % for euro-area countries and -/+11 % for non-euro area countries respectively;
- **private sector debt** in per cent of GDP, with a threshold of 160 %;
- **private sector credit flow** in per cent of GDP, with a threshold of 15 %;
- year-on-year **changes in the house price index** relative to a Eurostat consumption deflator, with a threshold of 6 %;
- **general government sector debt** in per cent of GDP, with a threshold of 60 %;
- three-year backward moving average of the **unemployment rate**, with a threshold of 10 %.

In view of the need to adjust to evolving macroeconomic conditions, the composition of the scoreboard is flexible. The design of the scoreboard could change over time to take into account improvements in data availability or enhancements in the underlying analysis and, even more importantly, new sources of potentially harmful macroeconomic imbalances that might develop in the future. Some changes in the scoreboard are already planned for the next annual cycle of surveillance: to capture possible imbalances in the financial sector, an additional internal indicator will be included by the end of 2012.

Recognising the critical importance of taking due account of country-specific circumstances and institutions, the economic reading of the scoreboard is complemented by additional information and indicators. This includes *inter alia* the general macroeconomic situation, such as growth and employment developments, nominal and real convergence inside and outside the euro area and specificities of catching-up economies. Additional indicators are considered that reflect the potential for the emergence of imbalances as well as the adjustment capacity of an economy, including its potential to sustain sound and balanced growth, such as different measures of productivity, inflows of FDI, capacity to innovate and energy dependence. The state of financial markets, which played an important role in the current crisis, will also be covered.

I.6. The 2012 Alert Mechanism Report and the way forward

As a first step in implementing the MIP, the Commission published its first Alert Mechanism Report on 14 February 2012.

This was done in a context of highly uncertain economic circumstances. All EU Member States are currently dealing with the adjustment to the impact of the crisis, although the challenges differ in terms of scope and severity. In addition to correcting the significant imbalances that built up over previous years, they are also dealing with the interrelated challenges of tackling low growth and high unemployment, ensuring sustainable public finances and restoring stability in the financial system. It is evident that a painful crisis-driven adjustment of macroeconomic imbalances is under way in many Member States, especially those that have or had high external deficits and large imbalances on household and corporate balance sheets.

Against this background, the first AMR made an economic reading of the scoreboard as provided for by the legislation and on this basis 12 Member States were identified as warranting in-depth reviews on different aspects of possible imbalances (see Table I.1 with the MIP scoreboard). Seven of them are euro-area

([5]) For a detailed discussion per indicator, see European Commission (2012), 'Scoreboard for the surveillance of macroeconomic imbalances', European Economy, Occasional Paper No 92 (February).

Table I.1: **MIP scoreboard 2012 (1)**

Year 2010	External imbalances and competitiveness					Internal imbalances				
	3 year average of **Current Account Balance** as % of GDP	**Net International Investment Position** as % of GDP	% Change (3 years) of **Real Effective Exchange Rate with HIPC deflators**	% Change (5 years) in **Export Market Shares**	% Change (3 years) in Nominal ULC	% y-o-y change in deflated **House Prices**	**Private Sector Credit Flow** as % of GDP	**Private Sector Debt** as % of GDP	**Public Sector Debt** as % of GDP	3 year average of **Unemployment**
Thresholds	**- 4/6%**	**- 35%**	**± 5% & ± 11%**	**- 6%**	**9% & 12%**	**+ 6%**	**15%**	**160%**	**60%**	**10%**
BE	-0.6	77.8	1.3	-15.4	8.5	0.4	13.1	233	96	7.7
DE	5.9	38.4	-2.9	-8.3	6.6	-1.0	3.1	128	83	7.5
EE	-0.8	-72.8	5.9	-0.9	9.3	-2.1	-8.6	176	7	12.0
IE	-2.7	-90.9	-5.0	-12.8	-2.3	-10.5	-4.5	341	93	10.6
EL	-12.1	-92.5	3.9	-20.0	12.8	-6.8	-0.7	124	145	9.9
ES	-6.5	-89.5	0.6	-11.6	3.3	-4.3	1.4	227	61	16.5
FR	-1.7	-10.0	-1.4	-19.4	7.2	3.6	2.4	160	82	9.0
IT	-2.8	-23.9	-1.0	-19.0	7.8	-1.5	3.6	126	118	7.6
CY	-12.1	-43.4	0.8	-19.4	7.2	-6.6	30.5	289	62	5.1
LU	6.4	96.5	1.9	3.2	17.3	3.0	-41.8	254	19	4.9
MT	-5.4	9.2	-0.6	6.9	7.7	-1.6	6.9	212	69	6.6
NL	5.0	28.0	-1.0	-8.1	7.4	-2.9	-0.7	223	63	3.8
AT	3.5	-9.8	-1.3	-14.8	8.9	-1.5	6.4	166	72	4.3
PT	-11.2	-107.5	-2.4	-8.6	5.1	0.1	3.3	249	93	10.4
SI	-3.0	-35.7	2.3	-5.9	15.7	0.7	1.8	129	39	5.9
SK	-4.1	-66.2	12.1	32.6	10.1	-4.9	3.3	69	41	12.0
FI	2.1	9.9	0.3	-18.7	12.3	6.6	6.8	178	48	7.7

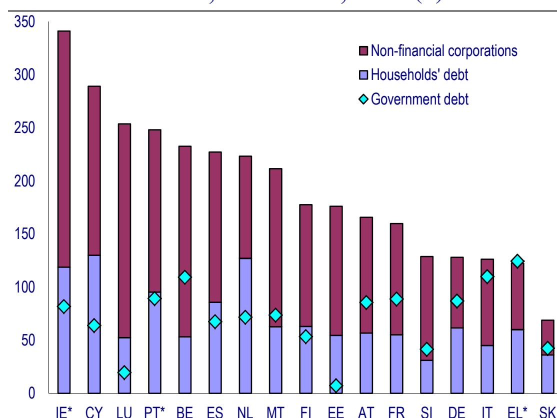
(1) The shaded cells in the table mark values that fall outside the scoreboard thresholds.
Source: Commission services

members: Belgium, Spain, France, Italy, Cyprus, Slovenia and Finland. The four programme countries (Greece, Portugal, Ireland and Romania) were not covered in the assessment as they are already under an enhanced programme-based surveillance regime.

The issues raised in the AMR as requiring further examination varied among the Member States concerned but to a large extent reflect the continuous adjustment to the imbalances built up in the years before the crisis described in Section I.2. Some countries need to correct accumulated imbalances on both the internal and the external side while others have to deal with issues concentrated in specific parts of the economy.

In particular, high levels of overall indebtedness appear challenging for a number of euro-area countries. While excessive credit flows have largely adjusted, many Member States are left with high levels of private sector indebtedness and are set for a likely prolonged process of deleveraging and adjustment in sectoral balance sheets (Graph I.5). In a number of cases, the deleveraging challenge for households and/or businesses is compounded by the high levels of public debt. The impact of deleveraging in the private sector could be magnified by the ongoing sovereign debt crisis exerting pressure on highly indebted public sectors. Elevated amounts of debt in the hands of non-residents can prove to be an additional concern in a context of high uncertainty in international financial markets.

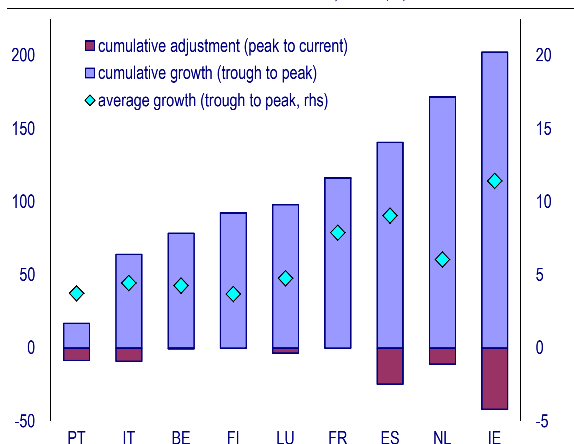
Graph I.5: **Gross indebtedness by institutional sector, % of GDP, 2010 (1)**



(1) Programme countries are marked with an asterisk.
Source: Commission services

Linked to the continuous build-up of indebtedness in the private sector, some countries also display developments in asset markets, in particular housing, that also warrant further analysis. This can be seen from Graph I.6, which shows the high cumulative house price increases in the upswing preceding the crisis in a number of euro-area countries and the limited adjustment that has taken place so far.

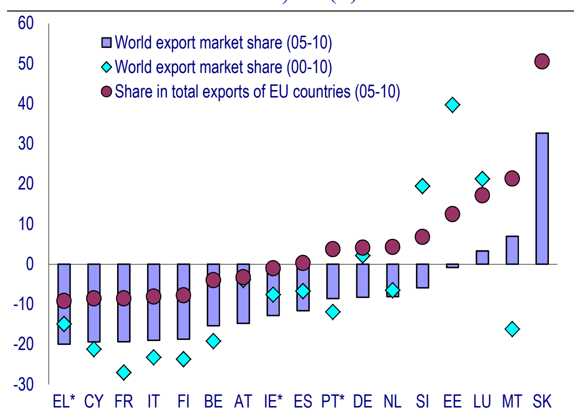
Graph I.6: **Housing market adjustment by Member State, % (1)**



(1) Programme countries are marked with an asterisk.
Source: Commission services

Losses in competitiveness and export market shares are also issues that need to be addressed. For example, many euro-area countries lost export market shares well beyond what would be explained by the rapidly increasing competition from emerging economies. Some euro-area countries, including Cyprus, France, Italy, Finland and Belgium, fared worse that the rest of their EU peers (Graph I.7).

Graph I.7: **Export market shares by Member State, % (1)**



(1) Programme countries are marked with an asterisk; world export market share (00-10) for SK is 108.2
Source: Commission services

Finally, the AMR envisaged analytical work in the months ahead that would explore this issue and serve as a basis for possible policy guidance. This analysis will explore the divergence in economic performance across Member States, including trade and financial interlinkages between deficit and surplus countries, and examine ways for further rebalancing 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.

Following its publication, the AMR was discussed in the Council, which broadly endorsed the proposed list of Member States for which in-depth reviews are warranted ([6]). In the coming months and in the context of the European Semester, the Commission will prepare in-depth reviews for these countries. These reviews will provide analysis of the challenges related to macroeconomic imbalances in the selected countries and pay particular attention to the key issues they are facing. In-depth analyses will thus help to assess the drivers of productivity, competitiveness and trade developments, the implications of the accumulated level of indebtedness, the adjustment in relative prices, including housing prices, and the progress in and speed of adjustment in the real economy. If corroborated by the findings of the in-depth reviews, policy recommendations will be issued to Member States under the preventive arm of the MIP or the corrective arm will be activated.

I.7. Conclusions

The MIP represents a major improvement in the economic governance framework in the EU. By covering the issue of macroeconomic imbalances, it will fill a gap in the surveillance of macroeconomic policies. While it is a promising tool for improving the coordination of economic policies in the EU and the euro area, only the effectiveness of implementation can ultimately determine its true value.

As 2012 will be the first year of implementation, the process is likely to evolve and develop over the years to come. In the case of the Stability and Growth Pact, targeted efforts to develop analytical approaches and tools have been made over time, guided by the requirements of the procedure in a learning-by-doing process. The toolkit supporting fiscal surveillance is much more advanced today than 10 years ago. In this sense surveillance under the MIP should also evolve over time and ultimately prove to be a useful tool not only in this ongoing crisis but also in helping to avoid the next.

([6]) See Ecofin conclusions of 13 March 2012 on the first AMR.