NOVA SCHOOL OF BUSINESS & ECONOMICS

SEMINAR IN EUROPEAN ECONOMICS

OTHER MAIN REFORMS: CRISIS PREVENTION AND RESOLUTION

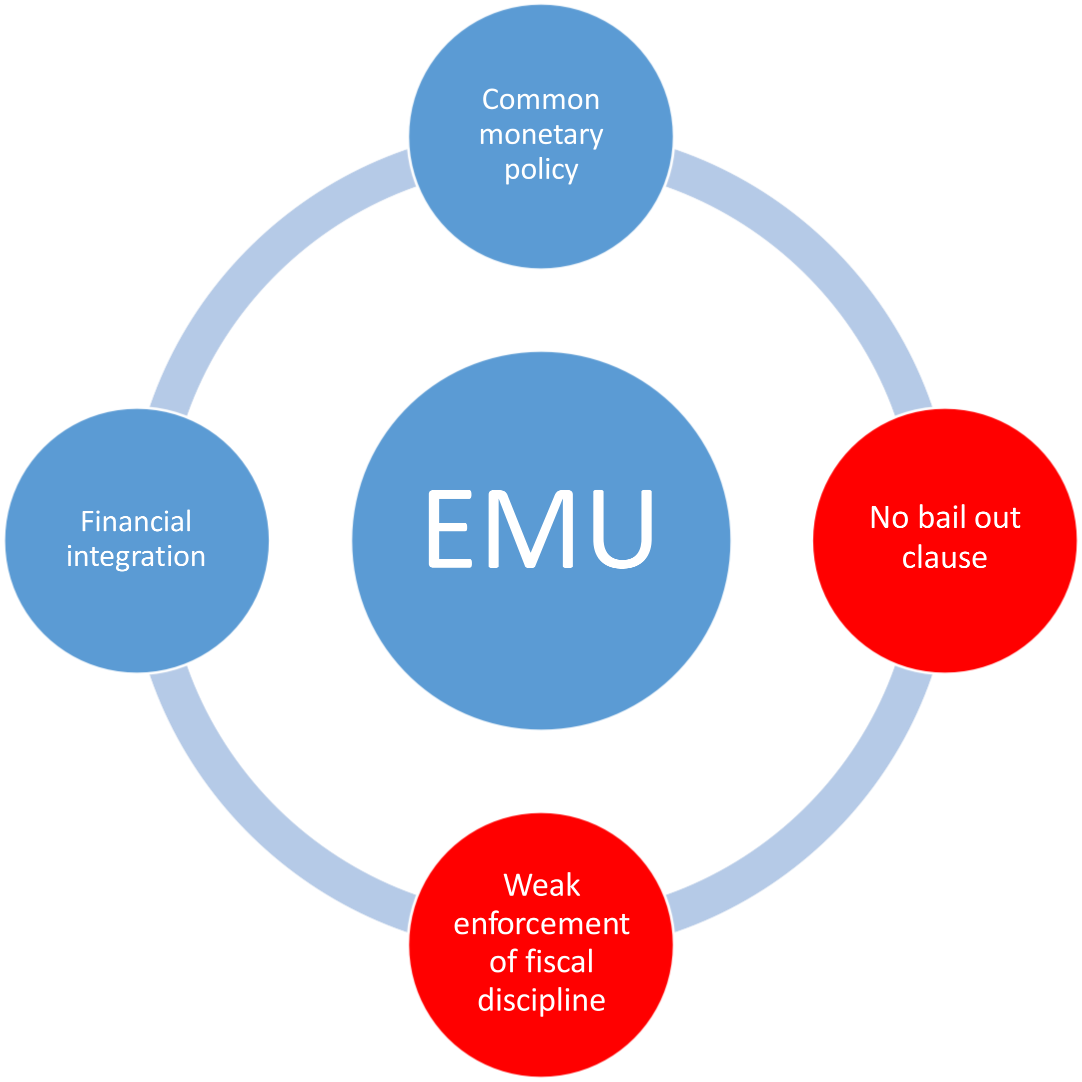
MACROECONOMIC IMBALANCE PROCEDURE

EUROPEAN STABILITY MECHANISM

PRACTICAL CLASS 6

2024-2025 S2

Was the institutional architecture adequate to allow the good functioning of a monetary union?



Financial integration exposes vulnerable countries to the risk of sudden stop

Macroeconomic imbalances make countries vulnerable

The Eurozone did not have adequate institutions and tools to deal with this problem (i.e. lender of last resort, currency devaluation, possibility of **fiscal transfers**…)

The **European Semester** ensures that Member States discuss their economic, social and budgetary plans with their EU partners at specific times in the first half of the year – hence the term Semester – so that national action can be accordingly taken in the second part of the year, notably with the adoption of the budgets for the subsequent year.

MACROECONOMIC IMBALANCE PROCEDURE

Integrated into the European Semester, the EU's annual cycle of economic monitoring and guidance.

- **Alert Mechanism Report (AMR):** annual report by the European Commission which analyses the economies of all Member States partly on the basis of a scoreboard of relevant indicators. The AMR identifies countries whose situations require deeper analysis, to be carried out in In-Depth Reviews that are included in the annual Country Reports.
- **In-Depth Reviews (IDR)** provide the analysis for the identification of the presence of macroeconomic imbalances and for the assessment of their severity. A Member State may be found to have 'no imbalances', 'imbalances', 'excessive imbalances', or 'excessive imbalances with corrective action' (implying the activation of EIP).
- **Specific Monitoring:** Member States with 'imbalances' or 'excessive imbalances' are subject to a process of Specific Monitoring of their policy commitments, adapted to the degree and nature of their imbalances, involving intensified dialogue with national authorities, and progress reports.
- **Excessive Imbalance Procedure (EIP):** enhanced surveillance mechanism designed to ensure compliance with the Macroeconomic Imbalance Procedure for countries identified with excessive imbalances with corrective action.

MACROECONOMIC IMBALANCE PROCEDURE


European Commission

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Alert Mechanism Report

2024

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EUROPEAN ECONOMY

Economic and Financial Affairs


European Commission

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In-Depth Review 2024

Spain

INSTITUTIONAL PAPER 272 | MARCH 2024

EUROPEAN ECONOMY

Economic and Financial Affairs

1. ALERT MECHANISM REPORT (AMR)

Scorebord Indicators, aimed at capturing the most relevant internal and external sources of macroeconomic imbalance and signal adjustment issues: 14 indicators and indicative thresholds, covering the major sources of macroeconomic imbalances.

External imbalances and competitiveness

- 3-year backward moving average of the current account balance as percent of GDP, with thresholds of +6% and -4%;
- net international investment position as percent of GDP, with a threshold of -35%;
- 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, 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 based on HICP/CPI deflators, relative to 41 other industrial countries, with thresholds of -/+5% for euro area countries and -/+11% for non-euro area countries;

Internal imbalances

- private sector debt (consolidated) in % of GDP with a threshold of 133%;
- private sector credit flow in % of GDP with a threshold of 14%;
- year-on-year changes in house prices relative to a Eurostat consumption deflator, with a threshold of 6%;
- general government sector debt in % of GDP with a threshold of 60%;
- 3-year backward moving average of unemployment rate, with a threshold of 10%;
- year-on-year changes in total financial sector liabilities, with a threshold of 16.5%;

Employment indicators

- 3-year change in p.p. of the activity rate, with a threshold of -0.2%;
- 3-year change in p.p. of the long-term unemployment rate, with a threshold of +0.5%;
- 3-year change in p.p. of the youth unemployment rate, with a threshold of +2%.

Imbalance defined as:

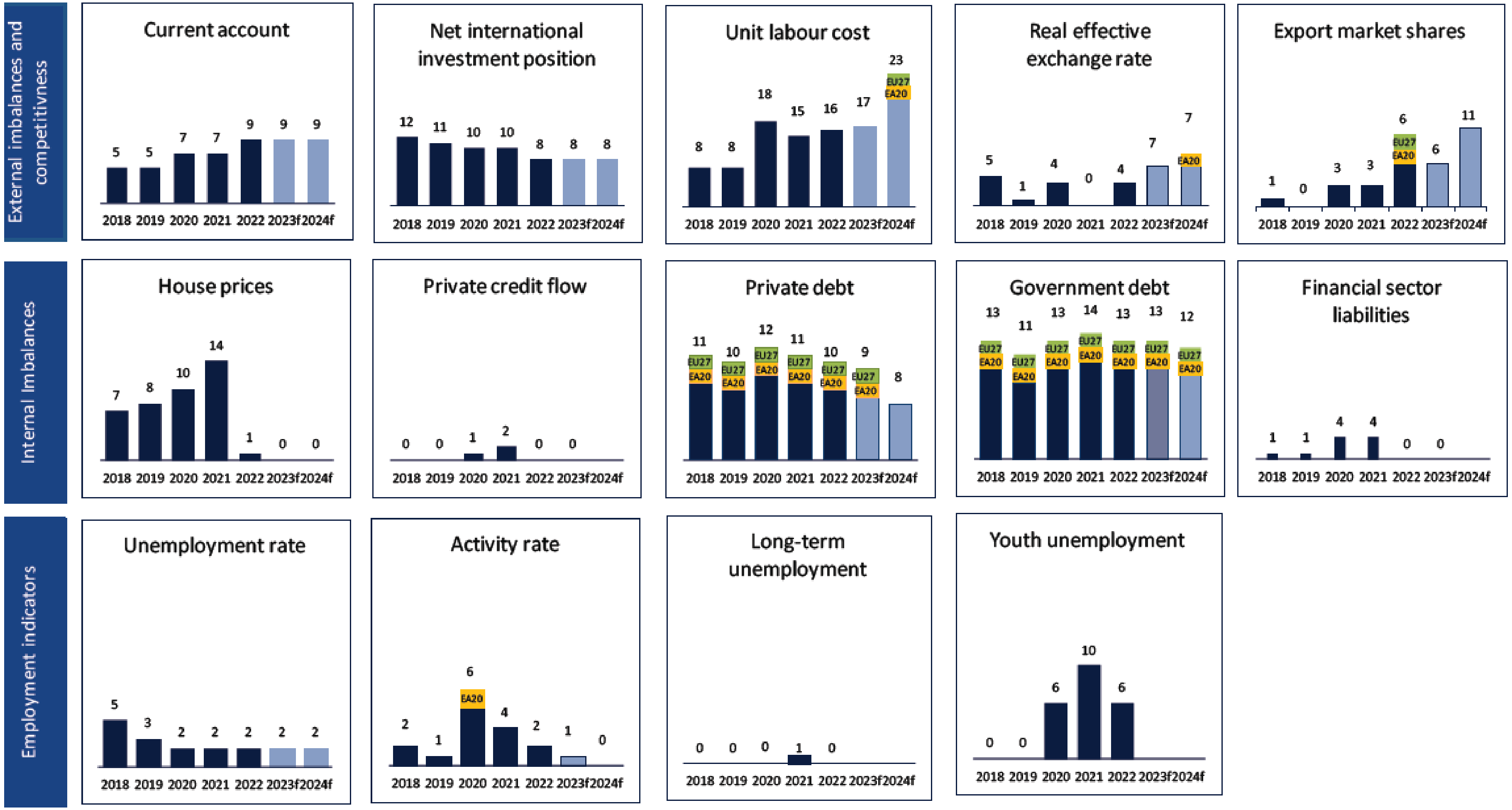
'any trend giving rise to macroeconomic developments which are adversely affecting, or have potential to adversely affect, the proper functioning of the economy of a Member State or of the economic and monetary union or of the Union as a whole'

Indicators:

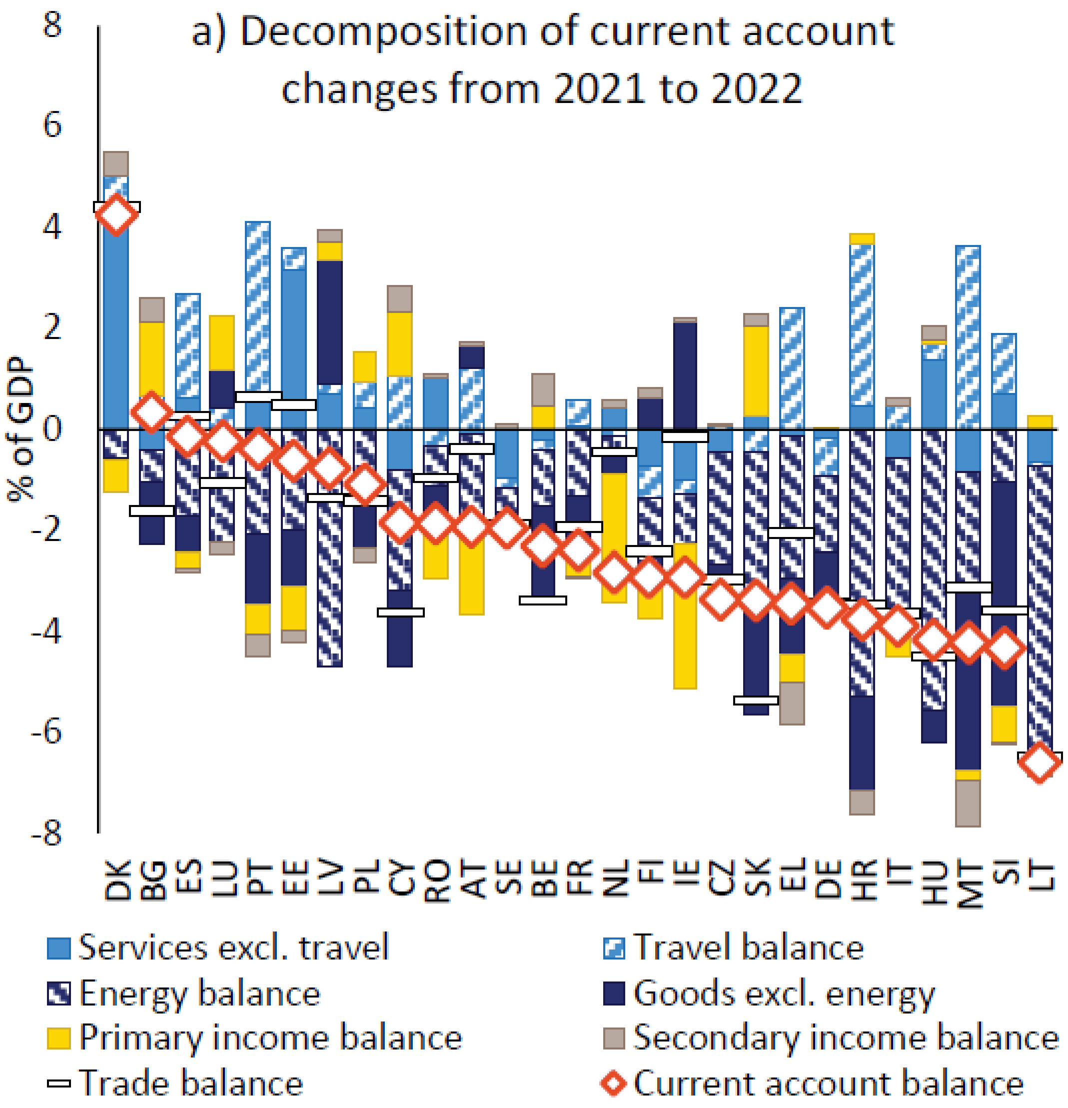
- Are they sufficiently forward looking to signal risk?
- Too many? May make it difficult to highlight most important imbalances
- Stocks or flows? Flows are more affected by policy measures
- In absolute or relative terms? Ex: if the deterioration of competitiveness is generalized to all countries, problem could be addressed by the depreciation of the euro

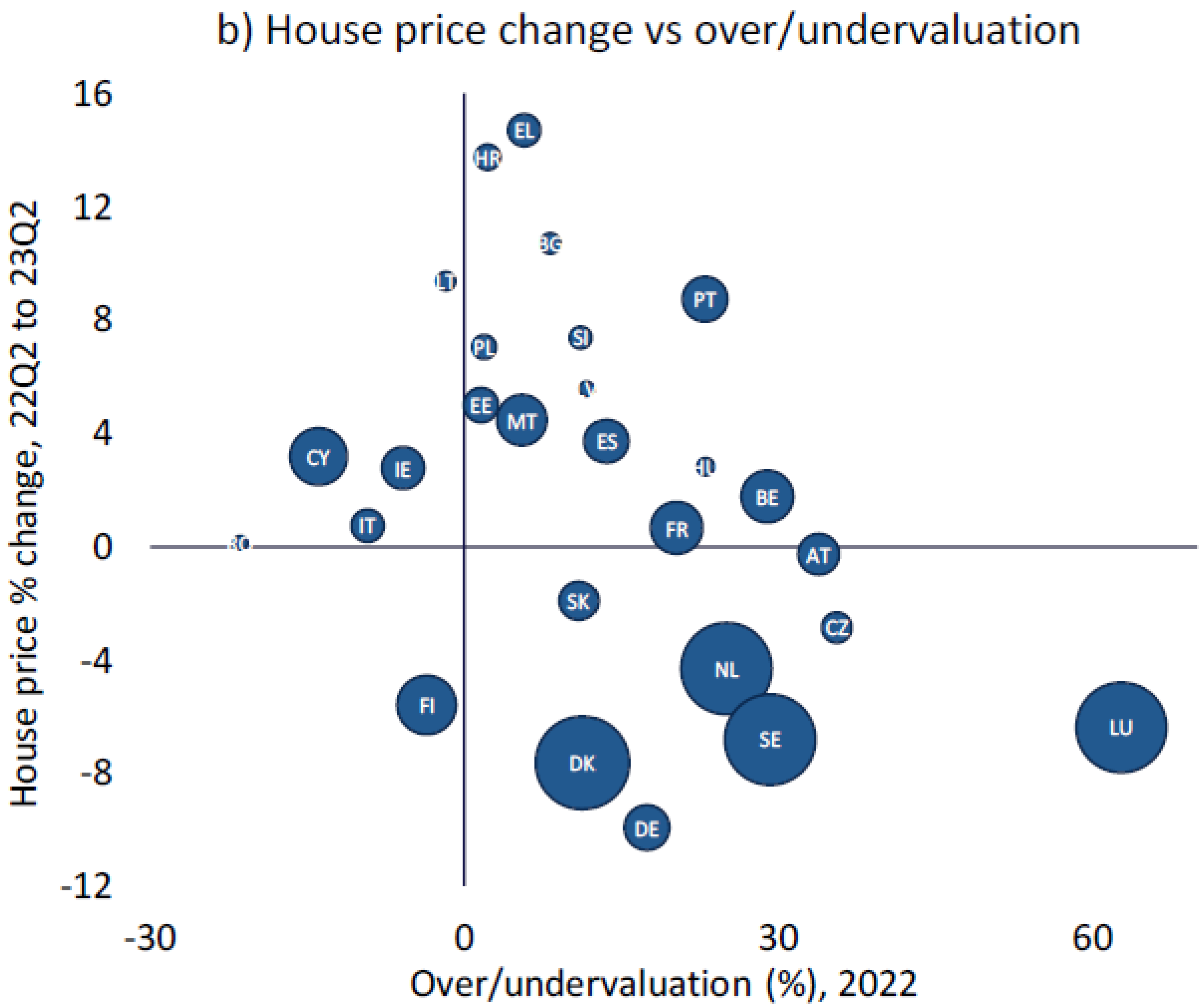
MACROECONOMIC IMBALANCES IN THE EU – SOME EXAMPLES

Graph A: **Number of Member States, and euro area and EU aggregates, recording scoreboard variables beyond thresholds**



MACROECONOMIC IMBALANCES IN THE EU – SOME EXAMPLES





MACROECONOMIC IMBALANCES IN THE EU – SOME EXAMPLES

Table 1.1: MIP Scoreboard 2022

2022	External imbalances and competitiveness					Internal imbalances						Employment indicators[1]		
	Current account balance - % of GDP (3 year average)	Net international investment position (% of GDP)	Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	Export market share - % of world exports (5 year % change)	Nominal unit labour cost index (3 year % change)	House price index, deflated (1 year % change)	Private sector credit flow, consolidated (% of GDP)	Private sector debt, consolidated (% of GDP)	General government gross debt (% of GDP)	Unemployment rate (3 year average)	Total financial sector liabilities, non-consolidated (1 year % change)	Activity rate - % of total population aged 15-64 (3 year change in pp)	Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)
Thresholds	-4%/+6%	-35%	±5% (EA) ±11% (Non-EA)	-6%	+9% (EA) +12% (Non-EA)	+6%	+14%	+133%	+60%	+10%	+16.5%	-0.2 pp	+0.5 pp	+2 pp
EU	1.5	1.5e	-1.0	-8.0	7.8	0.5	5.5p	133.0p	83.5	6.8	-2.3p	1.3	-0.3	-1.1
EA	1.3	3.2	-1.1	-8.4	7.9	0.4	5.3p	136.2p	90.9	7.5	-2.4p	0.9	-0.4	-1.7
BE	0.6	57.7	1.7	-1.9	10.1p	-3.8	5.7p	161.4p	104.3	5.9	-2.7	1.4	0.2	1.9
BG	-1.0	-12.9	5.8	15.5	23.6	-2.1b	5.9	74.6	22.6	5.2	12.0	0.5	-0.6	-1.4
CZ	-2.3	-19.7	13.7	-7.7	14.8	1.6	4.5	76.1	44.2	2.5	3.2	0.5	0.0	1.2
DK	10.2	58.2	-1.2	12.4	7.2	-7.4	13.1	188.0	29.8	5.1	-1.6	1.3	-0.3	0.5
DE	6.3	70.2	-0.5	-13.0	7.2p	-1.3	6.7p	118.4p	66.1	3.5b	1.5	1.4	-0.2	-0.2
EE	-2.6	-20.2	8.8	17.0	19.0	4.5	9.2	94.3	18.5	6.2	1.6	2.0	0.4	7.0
IE	6.0	-116.8	-4.6	32.1	-10.6	5.0	2.0	147.1	44.4	5.5	-4.0	3.5	-0.3	-2.4
EL	-7.9	-144.2	-2.5	12.6	3.5p	4.4e	1.1p	100.8p	172.6	14.9	-0.5	0.9	-3.6	-6.1
ES	0.7	-60.2	-0.7	-7.8	10.8p	0.8	0.3p	123.5p	111.6	14.4d	-4.5	0.2d	-0.3d	-2.7d
FR	-1.1	-23.8	-3.8	-10.7	11.1p	1.5	8.7p	163.9p	111.8	7.7d	-1.3p	1.0d	-0.3d	-3.4d
HR	-0.9	-25.4	-0.6	12.1	11.0p	3.2	6.0p	79.3p	68.2	7.4	9.5	3.4	0.0	1.4
IT	1.6	4.7	-1.9	-8.4	4.9	-3.2	2.9	105.5	141.7	9.0	-5.7	-0.2	-1.3	-5.5
CY	-8.0	-96.2	-3.0	20.7	-1.2p	-3.1	-3.9p	213.4p	85.6	7.3	-2.3	2.2	0.2	2.0
LV	-1.9	-26.5	5.7	15.3	16.7	-1.0	3.0	52.5	41.0	7.5	4.1	-0.5	-0.7	2.6
LT	1.0	-7.0	9.8	28.8	27.7	0.4	6.8	51.4	38.1	7.2	1.0	0.6	0.4	0.0
LU	8.0	47.0	-0.5	-0.8	13.2	4.0	-19.5p	325.5p	24.7	5.6	-4.9	1.5	0.0	0.6
HU	-4.5	-50.8	-8.1	-3.5	23.1p	5.1p	9.2p	78.8p	73.9	3.9	8.6	2.5	0.1	-0.6
MT	0.1	78.8	-3.1	2.7	8.6	1.2p	6.4	121.8	52.3	3.6	5.9	4.1	0.1	-1.0
NL	8.8	75.2	3.2	-0.1	9.8p	6.1	6.9p	210.1p	50.1	4.2	-3.7p	1.3	-0.2	-0.9
AT	1.6	17.6	0.1	-4.7	10.7	3.7	5.0	121.9	78.4	5.7	-3.0	0.5	-0.2	0.4
PL	-0.4	-33.4	-0.2	16.6	16.9p	-1.9	1.9	63.5	49.3	3.2	3.0	3.6	0.2	0.9
PT	-1.0	-83.6	-2.9	-1.9	10.7p	4.8	2.9p	141.1p	112.4	6.5	-4.0	1.5	-0.1	0.7
RO	-7.1	-40.6	2.6	6.7	10.4p	-6.2	3.3p	43.3p	47.2	5.8	8.2	3.5	0.2	1.8
SI	3.2	-1.5	-1.3	2.9	14.3	4.3	5.2	66.0	72.3	4.6	-1.4	1.6	-0.3	2.0
SK	-3.6	-61.0	3.8	-6.6	13.3	1.3	9.3	92.7	57.8	6.5	-9.3	1.4	0.2	2.8
FI	-0.5	-1.7	-3.1	-2.0	8.6	-4.6	2.3	144.7	73.3	7.4	1.7	2.5	0.0	-3.5
SE	5.8	34.8	-1.4	-2.7	5.8	-3.1	10.6	207.3	32.9	8.3	3.7	1.0	0.4	2.3

Figures highlighted are the ones at or beyond the threshold. Flags:b:Break in series. d:Definition differs. e:Estimated. p:Provisional.

1) For employment indicators, see page 2 of the AMR 2016. 2) House price index: b = break in time series due to new data source for BG; e = estimate by NCB for EL. 3) Private Sector Credit Flow: data for Luxembourg are preliminary estimates until the final structural business statistics survey becomes available. 4) Employment indicators and Unemployment rate: d = Spain and France have assessed the attachment to the job and included in employment those who had an unknown duration of absence from work, but are expected to return to the same job once COVID-19 health measures allow it.
Source: European Commission, Eurostat and Directorate General for Economic and Financial Affairs (for Real Effective Exchange Rate), and International Monetary Fund data, WEO (for world volume exports of goods and services)

MACROECONOMIC IMBALANCES IN THE EU – SOME EXAMPLES

Table 4.22: **Key economic and financial indicators, Portugal**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	forecast 2023	forecast 2024
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**0.0**	**-0.5**	**-1.0**	**-0.1**	**0.5**
Current account balance, balance of payments (% of GDP)		-0.1 (1)	-0.6 (2)	-1.0	-0.8	-1.1	1.6	1.1
Net international investment position (% of GDP)	**-35%**	**-55.1 (3)**	**-17.1 (4)**	**-104.6**	**-94.4**	**-83.6**	**-73.7**	**-67.9**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-46.7	-36.3	-29.6		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**15.6**	**13.3**	**10.7 p**	**7.7**	**9.4**
Nominal unit labour cost index (% y-o-y change)				8.7	1.3	0.5 p	5.7	2.9
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**-0.1**	**-2.8**	**-2.9**	**-1.7**	**-0.9**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.7	-1.7	-1.9	1.8	-0.9
Export market share - % of world exports (5 year % change)	**-6%**			**-1.8**	**-6.0**	**-1.9**	**0.5**	**-1.8**
Export market share - % of world exports (1 year % change)				-10.3	-0.4	7.3	4.1	-1.7
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**163.7**	**156.6**	**141.1 p**	**128.1**	**123.4**
Private sector credit flow, consolidated (% of GDP)	**14%**			**4.4**	**4.5**	**2.9 p**	**0.6**	**0.5**
Household debt, consolidated (% of GDP)		29.7 (6)	31.1 (7)	69.1	66.3	60.7p	55.2	
Non-financial corporate debt, consolidated (% of GDP)		45.6 (6)	55.4 (7)	94.6	90.3	80.4	72.9	
Housing market								
House price index, deflated (1 year % change)	**6%**			**8.1**	**7.3**	**4.8**	**-1.2**	**0.2**
House price index, nominal (1 year % change)		22.9 (8)		8.8	9.4	12.6	3.2	3.0
Government debt								
General government gross debt (% of GDP)	**60%**			**134.9**	**124.5**	**112.4**	**103.4**	**100.3**
General government balance (% of GDP)				-5.8	-2.9	-0.3	0.8	0.1
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**6.6**	**7.6**	**-4.0**	**-1.2**	
Return on equity (%)				0.0	4.9	8.7		
Common Equity Tier 1 ratio		10.6 (9)		15.4	15.5	15.3		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				4.9e	3.6e	3.0p	3.1	
Labour market								
Unemployment rate (3 year average)	**10%**			**7.0**	**6.8**	**6.5**	**6.4**	**6.3**
Unemployment rate (year level)		5.9 (10)		7.0	6.6	6.0	6.5	6.5
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.0**	**0.7**	**1.5**	**3.6**	**2.6**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-2.3**	**-0.3**	**-0.1**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-1.4**	**3.1**	**0.7**		

Current account	NIIP	REER	Export market shares
Nominal ULC	**Scoreboard**		House prices
Private credit flow	Private sector debt	Govern-ment debt	Financial sector liabilities
Unemp.	L-T Unemp.	Activity rate	Youth unemp.

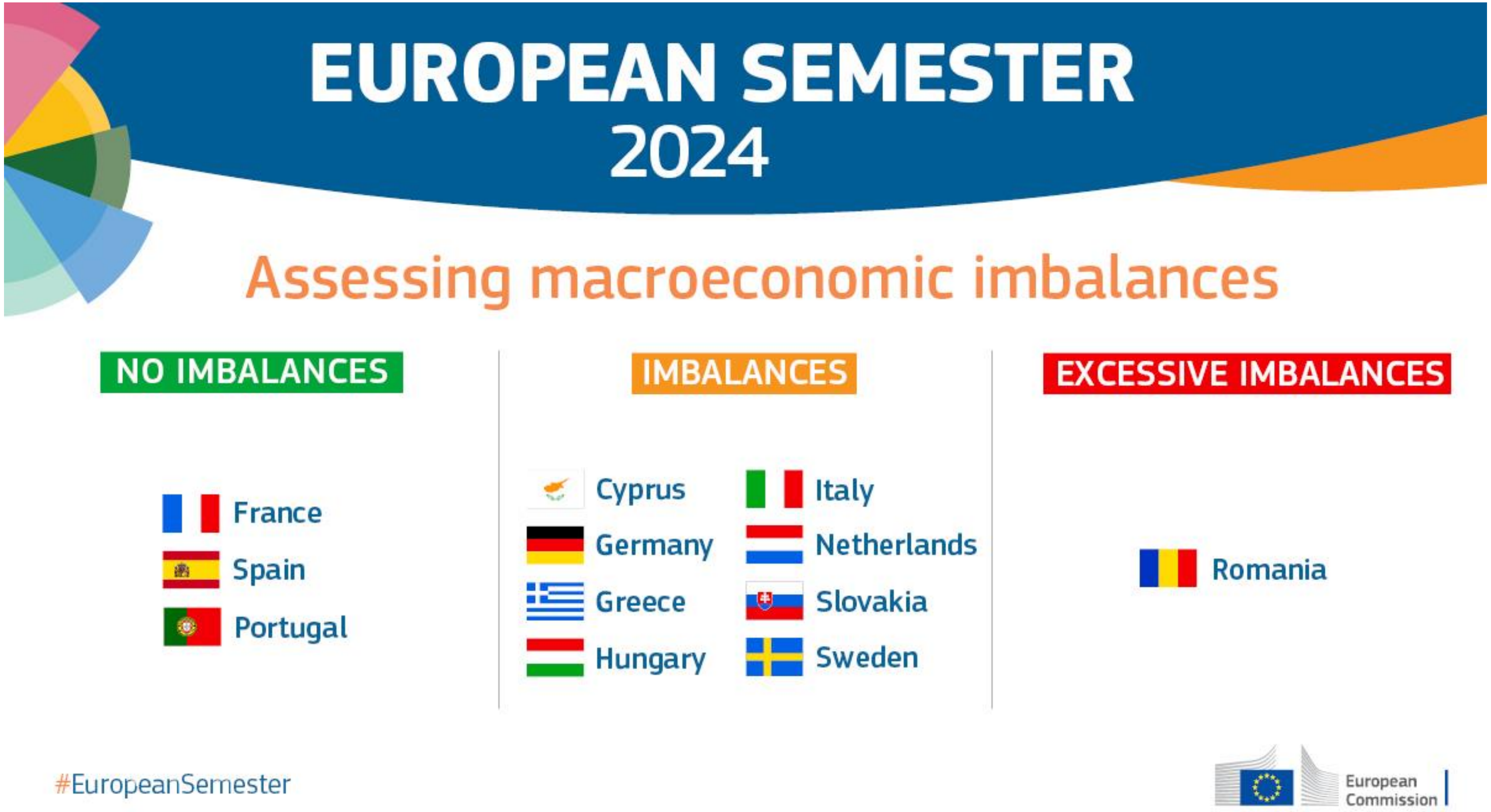
-1.0%	-83.6%	-2.9%	-1.9%
10.7%	**Portugal**		4.8%
2.9%	141.1%	112.4%	-4.0%
6.5%	-0.1%	1.5%	0.7%

2. IN-DEPTH REVIEW

Streamlined categories	Categories used in 2014 and 2015
No imbalances	No imbalances
Imbalances*	Imbalances, which require policy action and monitoring
	Imbalances, which require decisive policy action and monitoring
	Imbalances, which require decisive policy action and specific monitoring
Excessive imbalances*	Excessive imbalances, which require decisive policy action and specific monitoring
Excessive imbalances with Corrective Action Plan (EIP)	Excessive imbalances with Corrective Action Plan (EIP)

*under streamlined categories, specific monitoring applies both in the case of "imbalances" and "excessive imbalance" modulated according to the gravity of the challenges.

Results:


EUROPEAN SEMESTER
2024
Assessing macroeconomic imbalances
NO IMBALANCES
France
Spain
Portugal
IMBALANCES
Cyprus
Germany
Greece
Hungary
Italy
Netherlands
Slovakia
Sweden
EXCESSIVE IMBALANCES
Romania
#EuropeanSemester
European Commission

3. SPECIFIC MONITORING

- Member States identified as having ‘imbalances’ or ‘excessive imbalances’ by In-Depth Review receive specific monitoring adapted to the degree and nature of their imbalances.

- **Specific monitoring** is a form of intensified dialogue between the European Commission and national authorities that aims to help Member States address macroeconomic imbalances that could adversely affect their own economic stability or that of the euro area, or the EU.

- Specific monitoring involves fact finding missions by Commission officials to Member States and follow-up reports covering economic developments and the implementation of relevant policy measures.

4. EXCESSIVE IMBALANCE PROCEDURE

- **EIP** is an enhanced surveillance mechanism designed to ensure compliance with the Macroeconomic Imbalance Procedure for countries identified with excessive imbalances.

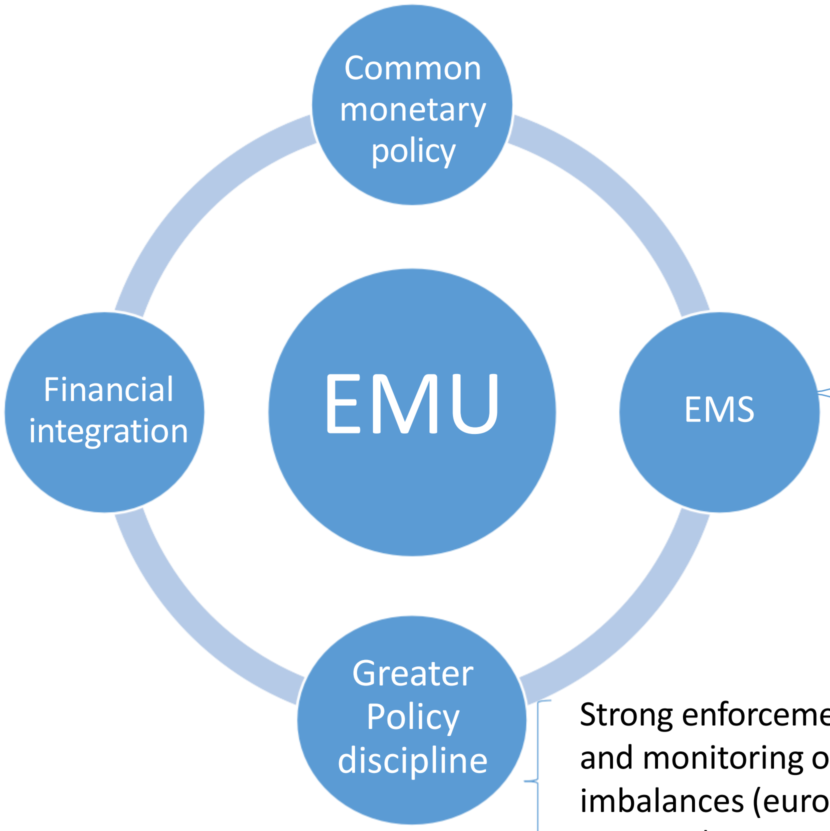
- Under the **Excessive Imbalance Procedure**, the European Commission may recommend to the Council that Member States experiencing excessive imbalances be required to submit **Corrective Action Plans** to address their situation.

- These plans must be approved by the Council and deadlines are set for their execution.

- The Commission and the Council monitor the implementation of the plans and the correction of the excessive imbalances, which is required to put an end to the EIP. Euro area Member States that repeatedly fail to submit corrective plans considered sufficient by the Council or to implement them face the possibility of sanctions, including fines.

EUROPEAN STABILITY MECHANISM

Reforms in the institutional architecture to promote the good functioning of a monetary union



- **To provide financial assistance to euro area countries experiencing or threatened by severe financing problems.**
- Necessary to safeguard the financial stability of the euro area as a whole and of ESM Members.

Strong enforcement of fiscal policy and monitoring of macroeconomic imbalances (european semester, MIP, SGP)

Treaty establishing the European Stability Mechanism (2012)

- Replaces European Financial Stability Facility and Mechanism (EFSF and EFSM)
- International organization aimed at providing financial assistance to EA countries with severe financial dificulties.
- Financial assistance subject to conditionality – as in a IMF programme.
- Countries with assistance from ESM are assumed to have signed a financial assistance programme with the IMF.
- The **ESM's mission** is to provide financial assistance to euro area countries experiencing or threatened by severe financing problems. This assistance is granted only if it is proven necessary to safeguard the financial stability of the euro area as a whole and of ESM Members.
- For this, the ESM counts on **several instruments**. The ESM can grant a loan as part of a macroeconomic adjustment programme, such as the one that was already used by Cyprus and Greece. Ireland, Greece, and Portugal have used similar programmes delivered by the EFSF. The only other instrument used was an ESM loan to recapitalise banks which was provided to Spain. See the full ESM toolkit below.

ESM Instruments

Lending toolkit

- Loans within a macroeconomic adjustment programme (IR, PT, GR, CY)
- Primary market purchases (unused)
- Secondary market purchases (unused)
- Precautionary credit line (unused)
- Loans for indirect bank recapitalization (SP)
- Direct recapitalisation of institutions (unused)

FOR DISCUSSION

1) The European sovereign debt crisis highlighted the need for a greater surveillance of macroeconomic imbalances and vulnerabilities in the European Union. (In Resit exam – June 2018)

a) Please describe the framework for the monitoring and surveillance of macroeconomic imbalances in the European Union.

- ***After the crisis there was the need to create stronger macroeconomic surveillance mechanisms***
- ***Within the stability and growth pact reform it was created the European Semester – to improve the way as countries are followed***
- ***The European Semester proposed the collection of data and indicators which frame the Macroeconomic imbalance procedure***

FOR DISCUSSION

1) The European sovereign debt crisis highlighted the need for a greater surveillance of macroeconomic imbalances and vulnerabilities in the European Union. (In Resit exam – June 2018)

b) Which institutions are involved in that exercise and what are their respective roles?

- ***The main institutions involved in the macroeconomic are the European Commission and the Council of ministers***
- ***The commission is responsible for the collecting the indicators and pointing the countries which are under "excessive imbalances", naming the countries which may need an in-depth review.***
- ***Based on this information the Commission proposes to the council the measures to take***
- ***The council takes the political decision about the measures to take***
- ***Both the council and commission make the follow up***

FOR DISCUSSION

1) The European sovereign debt crisis highlighted the need for a greater surveillance of macroeconomic imbalances and vulnerabilities in the European Union. (In Resit exam – June 2018)

c) Is this framework likely to be effective in preventing the emergence of major imbalances in the future?

- ***There is not sufficiently historic information to test it, particularly its enforceability – will penalties actually be applied?***

- ***All these rules were lifted to face the pandemic crisis***