Box 7

THE 2012 MACROECONOMIC IMBALANCE PROCEDURE

This year's "European Semester" (i.e. the framework for EU policy coordination introduced in 2011) includes, for the first time, the implementation of the Macroeconomic Imbalance Procedure (MIP).[1] The MIP, which was introduced by the "six-pack"[2] of economic governance reforms, aims to strengthen economic surveillance within the EU and the euro area in order to ensure that Member States conduct policies that prevent the emergence of harmful macroeconomic imbalances and correct such imbalances where they become excessive.

The need to monitor imbalances in the EU and the euro area is one of the key lessons learned from the ongoing crisis. In the years preceding the crisis, several Member States (not least in the euro area) did indeed accumulate excessive imbalances, which can be regarded as one of the root causes of the current situation. These included substantial losses in cost and price competitiveness, unsustainable domestic demand, growing current account deficits and the accumulation of excessive debt levels in the public and private sectors.[3]

Overview of the MIP

As laid down in two Council regulations,[4] the MIP begins with the publication of the Alert Mechanism Report (AMR). In this report, the European Commission provides a reading of the scoreboard of ten economic indicators[5] and corresponding thresholds for all 27 EU Member States, seeking to capture the major sources of macroeconomic imbalances. Countries currently the subject of EU/IMF programmes are excluded from the MIP, given that enhanced macroeconomic surveillance is already conducted as part of the respective programmes.

On the basis of the AMR, the Commission decides which countries require an in-depth review, with those countries then being assessed in greater detail to see whether early indications regarding macroeconomic imbalances are confirmed. The in-depth reviews include fact-finding missions to the countries in question and go beyond that initial reading of the scoreboard indicators. They should involve, among other things, a thorough analysis of (i) the sub-components and drivers of scoreboard variables, (ii) financial market vulnerabilities, and (iii) the potential implications of imbalances for the proper functioning of EMU. The Commission may, if appropriate, invite representatives of the ECB to participate in surveillance missions.

On the basis of each in-depth review, the Commission makes an assessment as to whether the country in question is (a) not experiencing any imbalances, (b) experiencing imbalances, or (c) experiencing excessive imbalances. In the first case, the MIP is terminated. Where it is decided that imbalances exist, the country concerned receives policy recommendations under

1 See the article entitled "The reform of economic governance in the euro area – essential elements", *Monthly Bulletin*, ECB, March 2011.
2 The "six-pack" is a legislative package of six legal texts adopted to strengthen the EU economic governance framework, and it entered into force in December 2011. It includes the reform of both the preventive and corrective arms of the Stability and Growth Pact (SGP), the new minimum requirements for national budgetary frameworks and the new Macroeconomic Imbalance Procedure (MIP).
3 See the article entitled "Monitoring labour cost developments across euro area countries", *Monthly Bulletin*, ECB, November 2008.
4 The MIP is laid down in Regulations (EU) No 1176/2011 of 16 November 2011 and No 1174/2011 of 16 November 2011.
5 See Table A for the ten scoreboard variables capturing indicators of external imbalances, competitiveness, and internal imbalances. For a detailed description of all indicators and thresholds, see "Scoreboard for the surveillance of macroeconomic imbalances", European Commission Occasional Papers, No 92, February 2012.

the "preventive arm" of the procedure with a view to averting potentially harmful developments. Where macroeconomic imbalances are found to be so severe that they are considered excessive, the Excessive Imbalance Procedure is triggered under the "corrective arm" of the procedure. In this case, the country concerned has to submit a corrective action plan outlining policy measures aimed at addressing the excessive imbalances, which have to be agreed by the Council of the European Union. In order to ensure the implementation of such corrective action, financial sanctions in the form of an interest-bearing deposit (with a rate of 0.1% of GDP) can be imposed by the Council where a euro area country does not comply with the agreed policy measures. Where a euro area country repeatedly fails to comply with policy recommendations or repeatedly submits an insufficient corrective action plan, an annual fine can be imposed.

Conclusions from the current stage of the 2012 MIP

The 2012 MIP was launched on 14 February 2012 with the publication of the AMR, in which the Commission identified twelve EU countries for which an in-depth review was warranted in order to verify the existence of macroeconomic imbalances. In this report, seven euro area countries (Belgium, Spain, France, Italy, Cyprus, Slovenia and Finland) and five non-euro area EU countries (Bulgaria, Denmark, Hungary, Sweden and the UK) were identified for an in-depth review.

On 30 May 2012 the Commission published the results of the twelve in-depth reviews, concluding that all countries identified are, to varying degrees, currently experiencing macroeconomic imbalances and should therefore be given country-specific recommendations under the preventive arm of the procedure. The Commission concluded that none of the twelve countries are currently experiencing excessive macroeconomic imbalances. As a result, the Commission did not initiate the corrective arm of the procedure for any country.

The scoreboard of ten indicators used for the surveillance of macroeconomic imbalances (Table A) depicts the indicator thresholds breached by the individual EU countries, applying 2010 annual data as in the Commission's AMR. While the absolute number of breaches is taken into consideration by the Commission, alleviating and aggravating country-specific factors are also taken into account. Thus, some countries have been identified for an in-depth review owing to the underlying developments pointing to more serious imbalances, despite their number of breaches being lower than in other Member States (see Table B).

In order to put the current level of imbalances into perspective, Table B shows how many of the scoreboard indicators' thresholds have been breached by EU countries since 2001. It shows that the scoreboard identified several macroeconomic imbalances in those countries that are now the subject of EU/IMF programmes (i.e. Ireland, Greece, Portugal and Romania) or that were the subject of such programmes in the past (e.g. Hungary and Latvia). In this sense, it indicates that the scoreboard would have provided the right signals for taking corrective action in these countries at an early stage.

The scoreboard also signals that in several other countries a significant number of imbalances existed and partly still exist. Most recently, in 2010, two countries – Spain and Cyprus – breached six thresholds, by far the highest number among all 27 EU Member States.

Table A The scoreboard for the surveillance of macroeconomic imbalances

2010	External imbalances: 3-year average current account balance as percentage of GDP	External imbalances: Net investment position as percentage of GDP	Competitiveness: Percentage change (3 years) in real effective exchange rates (REERs) with HICP deflators	Competitiveness: Percentage change (5 years) in export market shares	Competitiveness: Percentage change (3 years) in nominal unit labour costs
Countries[1]	EU27	EU27	EA and NEA	EU27	EA and NEA
Thresholds	**<-4 >6**	**<-35**	**±11 and ±5**	**<-6**	**>9 and >12**
1 Belgium	-0.6	77.8	1.3	-15.4	8.5
2 Germany	5.9	38.4	-2.9	-8.3	6.6
3 Estonia	-0.8	-72.8	5.9	-0.9	9.3
4 Ireland	-2.7	-90.9	-5.0	-12.8	-2.3
5 Greece	-12.1	-92.5	3.9	-20.0	12.8
6 Spain	-6.5	-89.5	0.6	-11.6	3.3
7 France	-1.7	-10.0	-1.4	-19.4	7.2
8 Italy	-2.8	-23.9	-1.0	-19.0	7.8
9 Cyprus	-12.1	-43.4	0.8	-19.4	7.2
10 Luxembourg	6.4	96.5	1.9	3.2	17.3
11 Malta	-5.4	9.2	-0.6	6.9	7.7
12 Netherlands	5.0	28.0	-1.0	-8.1	7.4
13 Austria	3.5	-9.8	-1.3	-14.8	8.9
14 Portugal	-11.2	-107.5	-2.4	-8.6	5.1
15 Slovenia	-3.0	-35.7	2.3	-5.9	15.7
16 Slovakia	-4.1	-66.2	12.1	32.6	10.1
17 Finland	2.1	9.9	0.3	-18.7	12.3
18 Bulgaria	-11.1	-97.7	10.4	15.8	27.8
19 Czech Republic	-2.5	-49.0	12.7	12.3	5.1
20 Denmark	3.9	10.3	0.9	-15.3	11.0
21 Latvia	-0.5	-80.2	8.5	14.0	-0.1
22 Lithuania	-2.3	-55.9	9.1	13.9	0.8
23 Hungary	-2.1	-112.5	-0.5	1.4	3.9
24 Poland	-5.0	-64.0	-0.5	20.1	12.3
25 Romania	-6.6	-64.2	-10.4	21.4	22.1
26 Sweden	7.5	-6.7	-2.5	-11.1	6.0
27 United Kingdom	-2.1	-23.8	-19.7	-24.3	11.3

2010	Internal imbalances: Percentage year-on-year change in house prices	Internal imbalances: Private sector credit flow as percentage of GDP	Internal imbalances: Private sector debt as percentage of GDP	Internal imbalances: Public sector debt as percentage of GDP	Internal imbalances: 3-year average unemployment rate
Countries[1]	EU27	EU27	EU27	EU27	EU27
Thresholds	**>6**	**>15**	**>160**	**>60**	**>10**
1 Belgium	0.4	13.1	232.8	96.2	7.7
2 Germany	-1.0	3.1	128.1	83.2	7.5
3 Estonia	-2.1	-8.6	176.1	6.7	12.0
4 Ireland	-10.5	-4.5	341.3	92.5	10.6
5 Greece	-6.8	-0.7	124.1	144.9	9.9
6 Spain	-4.3	1.4	227.3	61.0	16.5
7 France	3.6	2.4	159.8	82.3	9.0
8 Italy	-1.5	3.6	126.4	118.4	7.6
9 Cyprus	-6.6	30.5	289.2	61.5	5.1
10 Luxembourg	3.0	-41.8	253.9	19.1	4.9
11 Malta	-1.6	6.9	212.0	69.1	6.6
12 Netherlands	-2.9	-0.7	223.4	62.9	3.8
13 Austria	-1.5	6.4	165.7	71.8	4.3
14 Portugal	0.1	3.3	248.5	93.4	10.4
15 Slovenia	0.7	1.8	128.8	38.8	5.9
16 Slovakia	-4.9	3.3	69.0	41.0	12.0
17 Finland	6.6	6.8	177.7	48.3	7.7

Table A The scoreboard for the surveillance of macroeconomic imbalances (cont'd)

2010	Internal imbalances				
	Percentage year-on-year change in house prices	Private sector credit flow as percentage of GDP	Private sector debt as percentage of GDP	Public sector debt as percentage of GDP	3-year average unemployment rate
18 Bulgaria	-11.1	-0.2	169.2	16.3	7.5
19 Czech Republic	-2.6	1.7	77.2	37.6	6.1
20 Denmark	0.6	5.8	244.2	43.4	5.6
21 Latvia	-3.9	-8.8	140.9	44.7	14.3
22 Lithuania	-8.7	-5.3	80.8	38.0	12.5
23 Hungary	-6.7	-18.7	155.1	81.3	9.7
24 Poland	-6.1	3.8	74.2	54.9	8.3
25 Romania	-14.5	1.7	77.7	30.5	6.6
26 Sweden	6.3	2.6	236.9	39.7	7.6
27 United Kingdom	3.0	3.3	212.2	79.6	7.0

Source: European Commission Alert Mechanism Report February 2012.
Note: Light blue background denotes that the indicator exceeds the respective threshold.
1) Indicates the area to which a given threshold refers: EU27 – all EU countries; EA – euro area; NEA – non-euro area EU countries.

Table B Number of scoreboard indicators breaching the threshold

(simple sum of breaches in a given year)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Belgium	3	2	4	4	3	3	4	4	4	3
Germany	1	2	2	2	2	2	3	2	2	2
Estonia	4	4	5	5	5	5	4	6	5	5
Ireland	1	3	3	4	5	5	5	7	6	(6)
Greece	5	4	6	6	5	5	4	4	6	(5)
Spain	4	5	6	6	7	6	6	6	6	6
France	2	2	4	4	4	3	2	2	2	2
Italy	4	3	4	4	2	2	2	2	3	2
Cyprus	2	3	3	4	5	5	5	4	3	6
Luxembourg	3	3	3	3	3	3	3	3	3	3
Malta	2	2	3	4	5	6	5	7	5	3
Netherlands	4	2	3	2	2	2	2	3	3	3
Austria	1	1	1	1	1	1	2	1	4	3
Portugal	6	4	5	4	5	5	5	6	5	6
Slovenia	2	1	1	2	1	1	2	3	4	2
Slovakia	3	4	3	3	5	5	5	5	5	5
Finland	2	2	3	2	1	1	1	2	4	4
Bulgaria	5	3	4	4	5	6	6	6	6	4
Czech Republic	1	3	3	2	1	1	3	3	2	2
Denmark	2	1	1	3	3	3	3	4	2	2
Latvia	4	4	4	4	5	5	6	(4)	(5)	(2)
Lithuania	4	4	3	3	5	5	5	4	4	2
Hungary	4	5	5	4	5	4	4	(5)	(5)	(2)
Poland	4	3	2	3	2	3	4	4	3	3
Romania	1	3	2	2	3	6	6	4	(3)	(3)
Sweden	3	2	2	4	3	3	4	4	4	4
United Kingdom	2	4	4	4	3	3	4	2	4	4

Sources: European Commission (Statistical Annex of the Alert Mechanism Report, February 2012) and ECB calculations.
Notes: The European Commission's scoreboard lacks data for some indicators in some countries, particularly prior to 2006. Where data are not available, the country is regarded as not being in breach of the relevant threshold. Consequently, the total number of breaches could be revised upwards, since an increase in availability of data would mean that more breaches would be possible. Light blue background denotes country selected for an in-depth review. For the years in which a country was the subject of an EU/IMF programme, the number of breaches is shown in parentheses. The EU/IMF programme for Portugal started only in 2011.

While this mechanical reading of the scoreboard should be interpreted with caution and important caveats apply[6], it does provide some indications (broadly confirmed by more detailed economic analysis) as to the extent of the macroeconomic imbalances currently present in the countries concerned. Against this background, it is clear that several EU countries are currently in a state where they have to correct imbalances looking ahead.

Given the developments observed prior to the crisis, the strengthening of the framework for economic governance through the "six-pack" (particularly the MIP) has been a necessary step on the road towards a stronger euro area. However, the newly created MIP can only be successful in correcting current imbalances and preventing future imbalances if it is rigorously applied.

6 See Notes in Table B.

PRIVATE CONSUMPTION

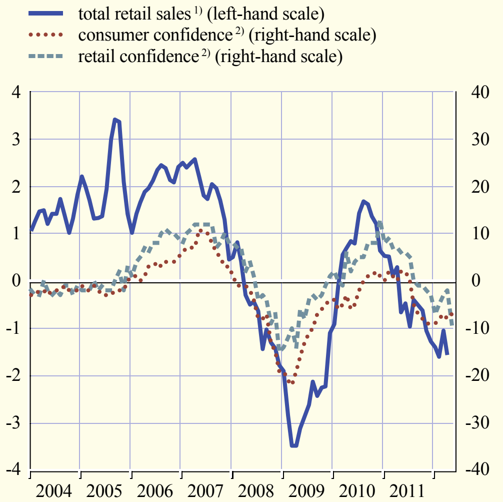
After a decline of 0.5% in the final quarter of 2011, private consumption displayed flat growth in the first quarter of 2012. Consumption thus stayed below its pre-recession peak of the first quarter of 2008. The outcome for the first quarter of 2012 is likely to reflect a higher consumption of services and a decline in car purchases, with the contribution from consumption of retail goods remaining broadly neutral. Recent information from short-term indicators and surveys points to a continuation of weak euro area consumer spending in the period ahead.

The sluggish developments in consumption largely reflect movements in real income, which is among the main determinants of consumer spending trends. Growth in aggregate real income started to decline in the course of 2011, on the back of weaker employment growth, and was further eroded by rising inflation. Household income in real terms declined year on year in the fourth quarter of 2011 for the second consecutive quarter. This, combined with continued elevated inflation, renewed uncertainty regarding the economic outlook and fiscal retrenchment, led to the household savings ratio rebounding somewhat from near pre-crisis lows.

For the second quarter of 2012, "hard" as well as "soft" data point towards a continuation of weak consumer spending. Retail sales in April declined by 1.0% compared with the previous month and the level therefore stood 0.8% below the average level recorded in the first quarter of 2012. The Purchasing Managers' Index (PMI) for retail sales increased from 41.3 in April to 43.3 in May. Even though the index improved, it still points to falling sales, as these figures are well below the no-growth threshold of 50. According to the European Commission, on average, retail confidence over these two months was somewhat below the average level recorded in the first quarter of 2012 as well as the long-term average. Euro area new passenger car registrations declined month on

Chart 52 Retail sales and confidence in the retail trade and household sectors

(monthly data)



Sources: European Commission Business and Consumer Surveys and Eurostat.
1) Annual percentage changes; three-month moving averages; working day-adjusted; including fuel.
2) Percentage balances; seasonally and mean-adjusted.