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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE

Alert Mechanism Report 2022

Prepared in accordance with Articles 3 and 4 of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances

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This alert mechanism report (AMR) initiates the eleventh annual round of the macroeconomic imbalance procedure (MIP). The procedure aims at detecting, preventing and correcting imbalances that hinder the proper functioning of Member State economies, the economic and monetary union or the Union as a whole, and at eliciting appropriate policy responses. The implementation of the MIP is embedded in the European Semester of economic policy coordination to ensure consistency with the analyses and recommendations made under other economic surveillance tools (Articles 1 and 2 of Regulation (EU) No 1176/2011).

The AMR analysis is based on the economic reading of a scoreboard of selected indicators, complemented by a wider set of auxiliary indicators, analytical tools and assessment frameworks, and additional relevant information, including recently published data and forecasts. This AMR includes a reinforced forward-looking assessment of risks to macroeconomic stability and for the evolution of macroeconomic imbalances. The AMR also includes an analysis of the euro area-wide implications of the Member States macroeconomic imbalances.

The AMR identifies Member States for which in-depth reviews (IDRs) should be undertaken to assess whether they are affected by imbalances in need of policy action (Article 5 of Regulation (EU) No 1176/2011). Taking into account discussions on the AMR with the European Parliament and within the Council and the Eurogroup, the Commission will then prepare IDRs for the Member States concerned. The IDRs will be published in spring 2022, and will provide the basis for the Commission assessment regarding the existence and severity of macroeconomic imbalances, and for the identification of policy gaps.

EXECUTIVE SUMMARY

This Alert Mechanism Report is the second one marked by the COVID-19 pandemic, as the economy recovers from the crisis that hit suddenly and unexpectedly in 2020. The COVID-19 pandemic caused an economic crisis unique in its severity. Following the disruptions in the first half of 2020, an initial phase of the economic recovery was quick to materialise when containment measures were eased across Europe. The deployment of vaccines marked a change in the economic outlook for the better. While differences among Member States persist, the efforts in dealing with immediate effects of the economic shock are bearing fruit. The successful rollout of vaccinations, accompanied by an effective and targeted containment strategy, brought a stronger revival of economic activity from spring 2021, and economic policy coordination has shifted to laying the foundations for a solid and inclusive recovery and stronger resilience. According to the Commission autumn 2021 economic forecast, most Member States are expected to close the distance to their pre-crisis output levels by the end of 2021, with only a few countries closing it next year.

The pandemic struck as most imbalances were undergoing a process of correction amid favourable macroeconomic conditions while new risks associated with signs of overheating were emerging. A sustained period of economic growth over most of the past decade facilitated a gradual correction of imbalances. These were related to high levels of private and public debt-to-GDP ratios, which were the legacy of both the global financial crisis and the build-up that preceded it. Large current account deficits or buoyant credit growth had also been corrected, resulting in external debt being gradually reduced and banking systems being strengthened. In more recent years, there had been a build-up of challenges and risks associated with signs of overheating in some sectors in some countries after a continued economic expansion, mainly at the level of house prices and cost competitiveness, especially in countries where economic growth was more buoyant.

The pandemic interrupted the reduction in debt-to-GDP ratios, while housing prices accelerated, suggesting an overall aggravation of macroeconomic risks. Imbalances related to high government and private debt worsened, driven by the sharp drop in GDP and the fiscal impact of the necessary measures taken to address the COVID-19 crisis, protecting production capacities and limiting the employment and social impact. House prices, which had already been buoyant, accelerated further and are a risk in several countries, in particular where they are accompanied by a significant increase in mortgage debt. Thanks to their strong capital ratios and high liquidity buffers, banks were able to keep providing credit to the economy. However, second round effects in the banking sector could materialise as protective measures are lifted and the longer-term impact of the pandemic on firm solvency works its way through the economy. External accounts worsened in countries dependent on cross-border tourism revenues. Extended policy support helped contain unemployment and stabilised household incomes. As the recovery takes hold, labour shortages and cost pressures are emerging in some countries, and substantial wage increases are foreseen in a number of countries.

The swift and coordinated policy response to the pandemic cushioned its economic impact, and the Recovery and Resilience Facility (RRF) provides a unique opportunity to emerge stronger from the crisis. The general escape clause of the Stability and Growth Pact was activated right after the pandemic outbreak, supporting national fiscal measures. Agreement on the State Aid Temporary Framework enabled Member States to use the full flexibility foreseen under state aid rules. The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) helped protect jobs. Governments delivered unprecedented fiscal and policy support, and the European Central Bank (ECB) implemented a broad range of measures to preserve financial stability and ensure the smooth functioning of financial markets. As the recovery unfolds, the effective implementation of reforms and investment in the recovery and resilience plans (RRPs) will help foster a durable recovery, strengthen resilience and accelerate EU's green and digital transitions. The implementation of RRPs can support a reduction in imbalances and mitigate macroeconomic risks. The plans provide a unique opportunity to place the Member States most affected by the COVID-19 crisis on a sustained higher growth path, which will foster job creation, improve debt sustainability and help to rebalance the European economy as a whole.

The horizontal analysis presented in the AMR can be summarised as follows:

- **The COVID-19 crisis has temporarily affected external positions, but has not fundamentally changed current account patterns.** Countries with important cross-border tourism sectors have generally seen a marked increase in current account deficits or a reduction in their modest surpluses. This is expected to correct gradually with the recovery in travel. Some of the large current account surpluses declined mildly in 2020, bringing the current account for the euro area as a whole in line with fundamentals. However, the data for the first half of 2021 show a marked increase in the euro area current account surplus, driven mainly by a higher balance of trade in services. The euro area current account is currently forecast to return to its 2019 level in 2021, reflecting continued subdued domestic demand. Overall, the largest changes in current accounts have been compositional: in all Member States, the private sector has increased its net saving position while the government sector's net lending positions decreased markedly because of the impact of the COVID-19 pandemic and of measures taken to mitigate it. Several Member States with large negative net international investment positions (NIIP) recorded a worsening of their current accounts in 2020, but the impact on their NIIP-to-GDP ratios is forecast to gradually reverse.

- **The disruption of economic activity in 2020 led to large increases in unit labour costs, which are expected to be partially reversed with the recovery, but labour shortages and cost pressures are emerging in a number of cases.** Unit labour costs rose across the EU as a result of stable employment headcounts despite sharply falling production, enabled by the various public job retention initiatives, especially short-time work schemes, which favoured a reduction in hours worked rather than employment levels. These effects are reflected in temporary reductions in headline labour productivity in 2020. With the recovery, productivity is edging up and reversing part of the losses in unit labour costs. In some countries though, wage increases are picking up sometimes resuming trends from before the pandemic. However, the labour market situation differs across sectors and countries, and while in some cases employment has broadly recovered to pre-crisis levels, in others gaps remain significant. In some cases, increased reallocation between jobs, firms and sectors may continue in the recovery and may lead to some permanent changes to the productive capacity of countries. In some other cases, labour shortages are emerging, especially in countries less affected by the crisis and amid higher demand. In combination with other factors, such as rapidly rising energy prices, cost pressures may turn significant and become a risk going forward.

- **A range of policy measures preserved jobs and production capacity during the crisis by supporting private sector liquidity and solvency**. Support measures such as moratoria on debt repayments and government guarantees for credit helped avoid private sector liquidity shortages turning into solvency troubles at the beginning of the COVID-19 crisis. Moratoria allowed a delay in debt repayments, increasing the nominal debt stock and related interest burden. With the phasing out of those measures, possible repayment difficulties may surface, especially in sectors more affected by the crisis and among firms already vulnerable beforehand. In many countries, increases in both corporate and households borrowing have been accompanied by increased net savings.

- **Corporate indebtedness increased in most EU countries in 2020, sometimes sharply.** New borrowing to cover sudden revenue losses and liquidity shortages resulting from the pandemic contributed to the increase in the corporate debt-to-GDP ratios on top of the effect of the sharp recession. While significantly increased net credit flows lasted until early 2021, their more recent moderation could be both a sign of lower demand, which could be related to corporations using accumulated liquidity, or lower supply of credit.

- **Household borrowing has picked up as the recovery strengthens.** In 2020, higher household debt-to-GDP ratios were mostly due to the large fall in GDP. Credit flows at the height of the pandemic were muted, mainly on account of a sharp fall in consumption loans. At the same time, many countries saw increases in mortgage loans in the face of high real estate market activity and accelerating house prices. Since early 2021, net credit flows have become more significant in several countries as the recovery unfolds.

- **The COVID-19 crisis and the measures governments took to cushion it have had a major impact on government debt.** The vital extensive support that governments have delivered has contributed to redirecting part of the adverse economic impact of the pandemic away from households and firms, protecting jobs and growth potential. Government debt-to-GDP ratios have increased more in the countries disproportionately affected by the recession, principally due to their tourism sectors. With the recovery, debt-to-GDP ratios are expected to stabilise and some have already started declining; but overall governments are emerging from this crisis with clearly higher indebtedness. The supportive fiscal stance and monetary policy measures have been mutually reinforcing in maintaining confidence and stability. Borrowing conditions for governments have remained supportive despite their increased financing needs, both due to monetary policy measures and longer-term factors such as the excess of savings over investment in the euro area. In light of inflation developments, costs of borrowing have tightened slightly but remain overall low. Borrowing costs have increased somewhat more for some Member States outside the euro area with floating exchange rates. Some of them have non-negligible shares of debt denominated in foreign currency or relatively short debt maturities.

- **The pandemic has been accompanied by a further acceleration of housing prices.** Following years of increases, house prices accelerated further in 2020 and the first half of 2021 and reached their fastest growth rates since the global financial crisis. Various EU countries are displaying risks of overvaluation. That raises concerns particularly where household debt is high or rising fast. The growth of house prices has been driven by a variety of factors fuelling demand and constraining supply. Supply constraints were already present before the pandemic and lockdowns exacerbated them temporarily. The pandemic may have led to some structural changes in housing demand as the shift to more remote working may change geographical preferences. Financial conditions have been accommodative and overall are likely to continue supporting elevated housing demand, while household incomes growing with the recovery are likely to sustain further house price growth.

- **The banking sector has maintained strong capital ratios but profitability weakened in 2020 and the full impact of the crisis on bank balance sheets may only be visible with a delay**. Conditions in the banking sector have improved considerably since the global financial crisis with capital buffers built up in the pre-pandemic years and capital ratios increased further in 2020, including due to temporary regulatory limits on dividend payments. The impact of the COVID-19 crisis on the banking sector has been limited thanks to the strengthening of the sector achieved after the financial crisis and due to extensive temporary policy measures such as credit guarantees, debt repayment moratoria or temporary regulatory relaxation. Non-performing loans continued decreasing in 2020, particularly in countries where they were sizeable and where banks disposed of legacy assets. However, the long-standing issue of low profitability remains. Moreover, the full impact of the crisis on asset quality, profitability and capital buffers may still materialise once the policy measures are withdrawn. Potential feedback loops between banks, sovereigns and the corporate sector should be closely monitored.

While the impact of the pandemic has been mitigated by the decisive policy action, the pandemic exacerbated divergences among euro area countries. Member States with a significant cross-border tourism sector were most exposed to the economic impact of the COVID-19 pandemic, leading to divergent impacts on employment and growth. As these countries were also characterised by relatively large public, private or external debts, this has led to a wider dispersion of indebtedness within the euro area. Some of these patterns are linked to temporary factors, such as the impact of the travel restrictions, but, despite the success of the decisive policy action in mitigating the widening of economic and social divergences, the crisis risks leaving a legacy and entrenching divergences.

A large current account surplus persists for the euro area as a whole, which highlights that there is room to sustain the recovery at the euro area aggregate level. This would also contribute to a faster reduction in imbalances. The current account for the area as a whole has temporarily declined to a level close to its fundamentals, but is projected to return to pre-crisis levels above fundamentals. The outcomes at Member State level vary very significantly. The external rebalancing in the euro area is all the more important given the limited room for additional monetary support to sustain demand.

In light of the interconnections among euro area economies, an appropriate combination of macroeconomic policies across Member States is needed in order to sustain the recovery, while correcting imbalances and addressing emerging risks. An economic expansion in euro area net-creditor countries, including on the basis of supportive demand conditions, would not only be beneficial for those countries themselves, but also for net-debtor countries, as higher growth in the euro area supports growth and deleveraging as well as the improvement in external positions in the latter group of countries. A withdrawal of the extraordinary policy support taken over the crisis timed to the adjustment needs would help in that respect. Marked and lasting improvements in productivity and competitiveness in net-debtor countries would also contribute to external rebalancing and help easing the debt burdens. An effective use of instruments put in place at euro area and EU level, with effective implementation of the necessary reforms and investment would help fostering a durable recovery and strengthening resilience, including by addressing imbalances and emerging risks. It will be crucial that Next Generation EU and Multiannual Financial Framework (MFF) financing is fully absorbed and channelled to the most productive uses. This would maximise the economic impact of the funds and contribute to balanced growth.

The full impact of the pandemic on imbalances will only be clear with a lag, as second round effects may play out. On the corporate side, pockets of underlying financial vulnerabilities due to depletion of equity following protracted losses and high debts remain. Some corporates could be affected by structural changes that necessitate adjustments to their business models. The expiration of support measures may lead to an increase in non-performing loans and bankruptcies at least in the sectors most affected by the COVID-19 crisis and among firms that were vulnerable prior to the crisis. This may take some time to materialise, depending on the types of forbearances that may be offered to otherwise insolvent borrowers. The ability of insolvency proceedings to clear existing impairments are important to ensure the flow of new credit to the economy. Government provision of guarantees for corporate loans help to preserve viable corporate entities, but if sizeable could also result in feedback loops between the corporate and government sectors, also affecting banks. Corporate balance sheet weaknesses risk having an impact on the labour market, and by extension the ability of some households to repay their credit. Strong increases in mortgage credit are an additional risk factor, particularly in the event of a correction in housing markets. Likewise, a further deterioration of commercial real estate asset prices might also weaken the financial sector.

Financing conditions will affect the evolution of imbalances. The low interest rate environment has enabled governments, corporations and households to take on higher debt and cushion the effect of the pandemic, protecting jobs and production capacity. An increase in interest rates would raise the financing costs of debt in both the public and private sectors, increasing risks where financing needs are high. Inflation has picked up markedly in the euro area and many other advanced economies since the beginning of 2021. While the determinants of this pick-up in inflation, including the surge in energy prices, appear mostly transitory, there is a risk that the duration may not be so short-lived. As long as financing conditions are not tightened, higher inflation can ease the debt burden. But a protracted increase in inflation could result in tighter financing conditions and higher borrowing costs.

Developments in housing markets warrant close monitoring. High house prices represent a risk, particularly when combined with high household indebtedness, compounded by uncertain labour market adjustments. This poses a risk for households' ability to meet their mortgage obligations. Increased interest rates could put additional pressure on mortgage repayment ability, with knock-on effects on the banking sector. Continued price increases as the recovery continues could feed into wage pressures and drive higher mortgage borrowing. Housing affordability has deteriorated in recent years, with potentially adverse macroeconomic consequences, linked to lower private consumption and labour mobility, and a diversion of credit away from productivity-enhancing investment.

Reducing the high levels of both government and private debt crucially depends on the recovery developing into a sustained expansion, which requires productive investment. A sustained recovery hinges on a supportive policy stance and well-timed withdrawal of the extraordinary policy support taken over the crisis. A sustained economic expansion depends on strengthening economic and social resilience, which requires the implementation of adequate reforms and investment. Productivity-enhancing investment is needed to drive growth in the medium term and to support structural transformations that are needed to deliver the green and digital transitions amid demographic change. That is all the more

important as a number of countries are marked by high public and private debt and relatively low potential growth, which makes reducing high levels of debt more difficult. In a situation of high government debt improving the composition of expenditure and revenue is needed to create the space from which public investment is delivered, as deleveraging, on the basis of a credible fiscal adjustment strategy, is also necessary to ensure space to address any future crises. At the same time, private investment may be hampered by corporate deleveraging needs. The effective implementation of the RRPs has an important role to play in supporting public and private investment, thereby helping to overcome the long-term impact of the pandemic and opening a path to stronger growth and resilience. The new RRF, in combination with European Structural and Investment funds, will promote an investment-rich recovery and their effective implementation will make the EU economy more sustainable, inclusive, resilient and better prepared for the green and digital transition, consistent with the Union objectives in that regard.

The pandemic has highlighted the positive role of counter-cyclical discretionary fiscal policy, supportive monetary policies and European coordination in responding to the economic crisis. The COVID-19 crisis has shown that sizeable discretionary fiscal reactions can be effective in mitigating the immediate impact of a large shock, and successful in paving the way for a swift rebound. The immediate national fiscal effort was buttressed by the use of flexibility existing within the EU regulatory frameworks. The collective reaction fostered confidence. Monetary policy measures contributed to preserving favourable financing conditions for all sectors of the economy throughout the pandemic, underpinning economic activity and safeguarding medium-term price stability. The mutually reinforcing effects of fiscal and monetary policies have been crucial for cushioning the impact of the crisis and supporting the recovery. While monetary policy is expected to remain accommodative in the coming years, the low interest rate environment and the recent edging up of inflation limit the possibility for further monetary easing. Fiscal policy may thereby need to maintain a stabilisation role if downside risks emerge while prudent budgetary policy in normal times creates confidence in the effectiveness of budgetary policy in times of crisis.

Preventing and correcting macroeconomic imbalances remains essential. First, a weak economic recovery could cause a spike in corporate bankruptcies leading to job losses as well as increased calls on crisis-related guarantees for corporate loans and a retrenchment of investment. Second, adverse economic developments could accentuate the sovereign-bank loops. Third, booming asset and house prices could increase the vulnerability of the household sector due to unsustainable asset price booms. These risks can adversely affect government debt sustainability, and limit the room for fiscal policy to respond to future challenges. Unwinding the build-up of vulnerabilities will also help consolidate the recovery and strengthen long-term growth. More similar economic structures and more synchronised business cycles will contribute to increasing the effectiveness of the common monetary policy.

By promoting an investment-rich recovery, the RRF will contribute to macroeconomic stability. The effective implementation of the recovery and resilience plans will make the EU economy more sustainable, inclusive, resilient and better prepared for the green and digital transitions. It will also help mitigate the risk of divergences within the EU as the RRF grants are targeted towards Member States with lower GDP per capita, higher unemployment and hit the hardest by the COVID-19 crisis. Moreover, in contrast to the years following the global financial crisis, higher public investment will support the post-pandemic recovery. RRF grants will fund high-quality investment projects and enable productivity-enhancing reforms, without giving rise to higher national deficit and debt ratios. These grants and other sources of EU financing are estimated to boost public investment in Member States by an average of about 0.5% of GDP per year in 2021 and 2022.

Preventing and correcting macroeconomic imbalances enhances Member States' ability to respond to shocks and supports economic convergence. Unwinding or preventing the build-up of imbalances will help consolidate the recovery and strengthen long-term growth. Countries with existing imbalances need to resume their pre-pandemic trajectory of correction, supported by policies to bolster potential growth. The reduction of imbalances can also yield positive spillovers across countries. Deeper economic and financial integration and more synchronised business cycles will contribute to increasing the effectiveness of the common monetary policy especially in the case of euro area members, enabling it to better respond to future challenges.

This AMR concludes that IDRs are warranted for 12 Member States: Croatia, Cyprus, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Romania, Spain, and **Sweden.** These Member States were subject to an IDR in the previous annual cycle of MIP surveillance, and were considered to be experiencing imbalances (Croatia, France, Germany, Ireland, the Netherlands, Portugal, Romania, Spain, and Sweden) or excessive imbalances (Cyprus, Greece, and Italy). The new IDRs will assess how those imbalances have developed, analysing their gravity, evolution and the policy response delivered by Member States, with the view to update existing assessments and assessing possible remaining policy needs. Section 3 provides a summary of how those imbalances have evolved and section 4 elaborates on country-specific information.

In addition, a number of Member States that were not subject to an IDR in the previous round display developments that merit particular attention. Slovakia is marked by strong house price growth alongside a sustained albeit slowing increase in household borrowing. Exports are markedly concentrated in a few specific sectors and there have been cost competitiveness losses, but export market shares have so far not been adversely affected. In the case of **Hungary**, the interplay between government borrowing and external financing in a context of significant debt exposure in foreign currency merits attention. House price growth has been strong. Cost competitiveness pressures are mounting, but export market shares have so far not been adversely affected.

There is also the need to monitor the development of risks in other Member States, in many instances linked to housing markets. In the case of Denmark and Luxembourg, developments in the housing market point to a build-up of risks. While changed preferences, supportive financial conditions and supply constraints may sustain house price growth, the risk of a downward correction, with potential implications for the wider economy, cannot be dismissed. Czechia is marked by strong house price growth and persistent cost competeviness losses that have been significant for some years. In Malta, growing private debt combined with weaknesses of the insolvency framework create particular vulnerabilities. Monitoring and surveillance should follow developments closely in these six Member States and ascertain whether they are consistent with and conducive to macroeconomic stability. The balance of risks does not at present point to a need for an IDR. Section 4 provides more information on country-specific developments.

1. THE MACROECONOMIC CONTEXT AND EVOLUTION OF IMBALANCES IN THE EURO AREA

The economic backdrop

This AMR is prepared against the economic backdrop of the COVID-19 pandemic. The initial impact of the pandemic was a sharp recession, as restrictive measures to contain the spread of the virus had a marked impact on economic activity in 2020. The result was a GDP retraction of 5.9% in the EU and 6.4% in the euro area in 2020, with considerable variation across countries. Some countries recorded falls at around or over the double-digit mark and others experienced mild recessions. The improving health situation enabled an easing of containment from the second quarter of 2020, starting the recovery. Different waves of the pandemic drove an uneven recovery until early 2021. The roll-out of vaccinations, accompanied by an effective and targeted containment strategy, as well as extensive public support measures enabled higher mobility and a stronger-than-expected revival of economic activity from spring 2021. Overall, the Commission autumn 2021 economic forecast expects GDP to grow by 5% in both the EU and the euro area in 2021 and by 4.3% in 2022. Most Member States are forecast to close the distance to their pre-crisis output levels by the end of 2021, with only a few countries closing it next year (Graph 1.1 a). ([1])

While the impact has been mitigated by the decisive policy action, the pandemic exacerbated divergences among euro area countries. This reflects the uneven toll of the pandemic and differences in economic structures. Contact-intensive services have been more adversely affected by the restrictions than manufacturing. This has resulted in a wide divergence in the economic performance, both within and across countries. Countries that have substantial cross-border tourism sectors, and have been particularly affected by the mobility restrictions, experienced sharper-than-average GDP contractions alongside substantial deteriorations of their external accounts. This is the case for Greece, Portugal and Spain. The recession has also hit hard countries with high domestic debt such as France and Italy (see Graph 1.1 b). Those are also countries with some of the highest private, government or external debts in the EU. The recovery is forecast to be slower in some of these countries.

An exceptional policy response has been crucial for cushioning the impact of the COVID-19 crisis and for supporting the recovery, while having a positive impact on macroeconomic stability. Governments have delivered unprecedented fiscal support in order to protect jobs and incomes and support businesses, reducing the risk of corporate bankruptcies. Moratoria were provided for tax payments and debt repayments by households and corporations, and government guarantees were provided for bank loans. As a result, in 2020, household gross disposable income was essentially constant in the EU as a whole despite the marked recession. The EU's unemployment rate rose by just 0.4 percentage points and corporate bankruptcies were very contained, as much of the impact was absorbed by governments.

An unprecedented coordination of policy responses took place at EU level. The general escape clause of the Stability and Growth Pact was activated right after the pandemic outbreak, supporting fiscal measures. Agreement on the State Aid Temporary Framework enabled Member States to use the full flexibility foreseen under state aid rules. The European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) protected labour markets. The Coronavirus Response Investment Initiatives (CRII and CRII plus) and REACT-EU mobilised and topped up cohesion policy funds to support the public health sector, enterprises and the most vulnerable population. Financial instruments were made available by the European Stability Mechanism and the European Investment Bank. The effective implementation of reforms and investment Recovery and Resilience Facility (RRF)

([1]) European Commission, European Economic Forecast Autumn 2021, Institutional paper 160, November 2021. See also Croitorov O. et al. (2021), "The macroeconomic impact of the COVID-19 pandemic in the euro area" *Quarterly Report on the Euro Area*, DG ECFIN, European Commission, Vol. 20, No 2, Part I.

will help make the EU economy more sustainable, inclusive, resilient and better prepared for the green and digital transition, consistent with the Union objectives in that regard.

A concerted global monetary policy response led to accommodative financial conditions. The European Central Bank (ECB) implemented a broad range of measures to preserve financial stability and ensure the smooth functioning of financial markets. It provided additional liquidity for banks, eased collateral requirements, and undertook substantial additional purchases of public and private sector assets. The accommodative monetary policy stance underpinned benign financial market sentiment and helped avoid a credit crunch, and valuations in many bond and stock markets surpassed pre-pandemic levels. Together with longer-term factors, including the excess of savings over investment in the euro area amongst others, high market liquidity ensured low sovereign borrowing costs, in some cases even lower than before the onset of the crisis and spreads within the euro area narrowed. Expectations of a strong recovery added to the positive sentiment in the markets, reinforced by the breakthrough in vaccine developments in autumn 2020.

Financial conditions remain at historical low levels but signs of tightening should be monitored. Although sovereign bond yields have risen slightly in 2021, they typically remain well below historical averages. Governments with the strongest ratings enjoy negative or close-to-zero interest rates on their debts, while some increases have occurred in a number of Member States especially outside the euro area. Easy, albeit slightly tightening, financing conditions have been evident in corporate bond markets and bank lending rates have been at or close to record lows in the EU. The euro appreciated in the second half of 2020 before receding somewhat, and this was mirrored by the currencies of a few non-euro area members.

Inflation picked up in 2021 but the increase is expected to be mostly transitory. Headline inflation in the euro area rose to a ten-year high in recent months, following below-target inflation over almost a decade. Inflation has been above targets in a number of non-euro area Member States. Energy price increases have been a major contributor to the increase, with core inflation increasing less. The pick-up in inflation is expected to be mostly transitory, although not necessarily short-lived. Some frictions tied to the transition away from fossil fuels may take a while to resolve. The economic reopening has brought a marked increase in demand but activity is constrained by supply bottlenecks. Some pass-through of rising costs to some consumer prices is likely, although its extent is uncertain, and reduced profit margins may absorb some of the increase. The risks of sustained inflation dynamics currently seem contained, as inflation expectations in the euro area remain well anchored and broadly reflect a return to pre-pandemic trends. However, structural adjustments, including the reaction of consumption patterns to the pandemic and industry-specific skills shortages, may affect relative prices and wages, which may increase inflation volatility. A protracted increase in inflation could lead to changes in the timing of the normalisation of monetary policy and result in tighter financial conditions and higher borrowing costs.

The EU economy is recovering faster than anticipated but the economic outlook remains uncertain. Across the EU, successful vaccination campaigns have reduced the need for strong containment measures to address future infection waves. Globally, pandemic-related risks remain relevant due to lower vaccination roll-out. Trade is still recovering from the pandemic-induced restrictions and it has been dampened by supply-side bottlenecks, which affect activities highly integrated in global value chains. Lasting re-orientations of value chains generate costs and may bring risks as well as opportunities for EU countries. The erosion of firms' profitability and the rise in leverage have reduced private investment. This can detract from the recovery, and hamper corporate deleveraging. The withdrawal of policy support may trigger a repricing of risk. Uncertainty could heighten volatility in financial markets with adverse effects on financial and real estate asset prices given a general decoupling of securities prices from economic fundamentals. ([2]) ([3]) ([4]) On the upside, faster progress in controlling the pandemic worldwide

([2]) European Securities and Markets Authority (2021), ESMA Risk Dashboard, 3 June 2021. https://www.esma.europa.eu/sites/default/files/esma50-165-1761_risk_dashboard_no_1_2021.pdf

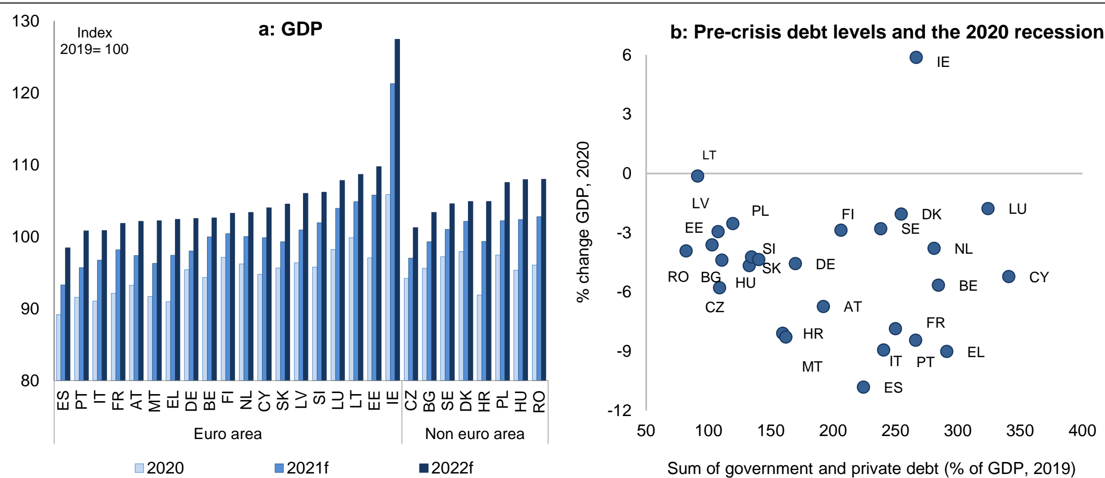
([3]) Tightening of monetary policy by the Fed could also affect financing conditions of the euro area corporate sector, especially as globalisation has altered the transmission mechanism of monetary policy and its spillovers abroad, and Fed's monetary policy has a sizeable impact on foreign financial variables such as corporate bond spreads. Ca'Zorzi M. et all (2021), Making waves – Fed spillovers are stronger and more encompassing than the ECB's, ECB's Research Bulletin No 83, 15 April 2021, https://www.ecb.europa.eu/pub/economic-research/resbull/2021/html/ecb.rb210415~8639b73bb6.en.html

([4]) See also IMF (2021), Global Financial Stability Report, October 2021.

and the implementation of ambitious and coordinated reforms and investment across the EU could pave the way for a sustained recovery.

The strong recovery is supportive of macroeconomic stability but second round effects from the recession may come with a lag and still pose risks. Amid strong GDP growth, high government and private sector debt ratios have stabilised or are slightly declining in most EU countries after increasing markedly last year. The removal of policy support will inevitably expose potential underlying vulnerabilities in industries and areas most affected by COVID-19. The lifting of moratoria on debt repayments could lead to debt servicing difficulties for firms and households, and result in corporate insolvencies and unemployment. The interlinkages between sovereign and private debts and the financial sector are a mechanism for the transmission of risks. A deterioration in government and private asset quality may affect the balance sheets of financial institutions, whose low profitability has fallen further under the pandemic. Difficulties in servicing debt may reduce investment, household incomes and consumption, dampening economic growth and undermining deleveraging. The pandemic has led to a deterioration of cost competiveness in a number of countries with strong labour cost increases already before the crisis, which are in some cases forecast to continue. House prices are growing at their fastest pace in over a decade, uninterrupted or even reinforced during the pandemic. Unlike the increases in indebtedness, the economic recovery is unlikely to lead to a correction in housing prices, although some short-term supply difficulties may ease. Accelerating house prices are a concern for macroeconomic stability especially when accompanied by high household debt and strong credit growth. Worsening housing affordability can have economic costs by reducing consumption and undermining labour mobility. At the same time, real estate and other asset price corrections could lead to a deterioration of balance sheets of financial institutions.

Graph 1.1: **GDP in relation to pre-pandemic levels and pre-crisis debt levels and the COVID-19 recession**



Source: AMECO, Eurostat and European Commission 2021 autumn economic forecasts

Spill-overs and euro area adjustment issues (5)

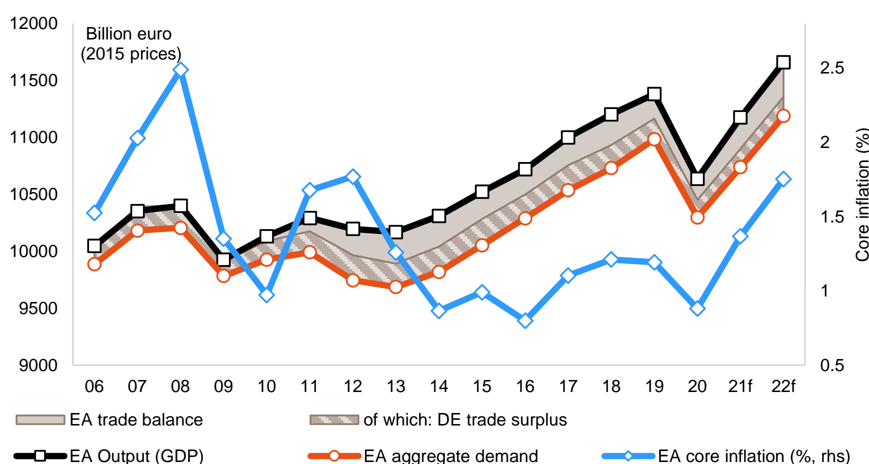
The COVID-19 crisis has exacerbated imbalances within the euro area. The majority of the countries that were most affected by the COVID-19 crisis were those that entered the pandemic with higher government, private sector or external debt, in some cases compounded by low potential GDP growth. The COVID-19 crisis has markedly affected the external positions of net-debtor countries with large tourism sectors with more limited effects on other countries' external accounts. Some of the countries hit

(5) More attention to the euro area dimension of imbalances was proposed in the 22 June 2015 Report 'Completing Europe's Economic and Monetary Union' by Jean-Claude Juncker, Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz. The role of interdependencies and systemic implications of imbalances is recognised in Regulation (EU) No 1176/2011, which defines imbalances with reference to "macroeconomic developments which are adversely affecting, or have the potential adversely to 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." The analysis contained in this report accompanies the assessment provided in the European Commission Staff Working Document "Analysis of the Euro Area economy", accompanying the Commission Recommendation for a Council Recommendation on the economic policy of the euro area.

hardest by the recession are recovering fast but the recovery in others is progressing more slowly. This suggests that economic growth may contribute less to addressing stock-related imbalances, at least in the near future, and highlights the importance of effective reforms and investment to address structural weaknesses and boost potential GDP going forward. ([6])

The euro area trade balance increased slightly in 2020 as output declined in tandem with falling demand. Both exports and imports of goods and services declined in 2020. The surplus of trade in goods strengthened, largely supported by lower energy prices, while the services surplus fell, mainly due to the fall in international travel. Overall, this paused the reduction in the euro area trade surplus that started in 2017. The trade balance is forecast to expand slightly in 2021 and remain broadly constant in 2022 (Graph 1.2). In 2021, despite the still sizeable output gap, euro area core inflation (headline inflation excluding energy and unprocessed food) is expected to pick up while remaining below the headline inflation target.

Graph 1.2: **Euro area output, domestic demand, trade balance and core inflation**



Note: while the difference between GDP and domestic demand should equal the trade balance by definition, data are not fully aligned due to intra-euro area reporting discrepancies.
Source: AMECO and European Commission autumn 2021 economic forecast.

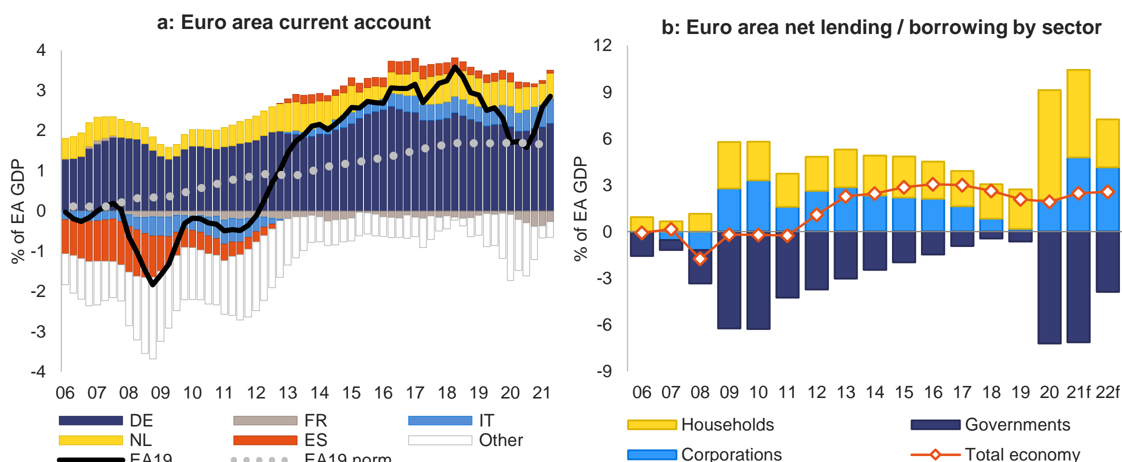
The euro area current account surplus continued its gradual decline in 2020 to the level consistent with that suggested by euro area fundamentals but is increasing again in 2021. In 2020, the euro area current account recorded a surplus of 2% of GDP (Graph 1.3 a). ([7]) Despite the slight increase of the trade balance, slightly lower income balances brought about the small decline of the current account. Both the headline and cyclically-adjusted current accounts that equalled 1.6% of GDP came close to the current account norm that reflects the euro area's economic fundamentals, estimated at 1.7% of GDP. ([8]) That reflected domestic demand holding up better than in most trade partners. However, data for the first half of 2021 show an increase in the euro area current account surplus, driven mainly by a higher balance of trade in services. Overall, the euro area current account is currently forecast to return to its 2019 level in 2021. This reflects a return of the difference between GDP and aggregate demand to its pre-pandemic level, and thus the persistency of subdued domestic demand (Graph 1.2).

([6]) See also E. Meyermans, V. Rutkauskas and W. Simons (2021), “The uneven impact of the COVID-19 pandemic across the euro area”, *Quarterly Report on the Euro Area*, DG ECFIN, European Commission, Vol. 20, No 2, Part II.

([7]) The euro area current account surplus mentioned and used here is taken from euro area balance of payments statistics, which is consistent with the current accounts Member States report vis-à-vis partners outside of the euro area (under the so-called "community concept"). This figure may differ from the sum of Member State headline current account balances, due to asymmetries in the intra-euro area balances reported by the different national statistical institutes.

([8]) The IMF model estimate of the euro area current account norm comes at 1% of GDP in 2020 (see IMF (2021) External Sector Report, August 2021), which would imply a gap of 0.8% of GDP to the cyclically-adjusted current account (which equals 1.8% of GDP in their report). However, after making adjustments for the transitory impact of the COVID-19 crisis the estimated gap is reduced to 0.6%.

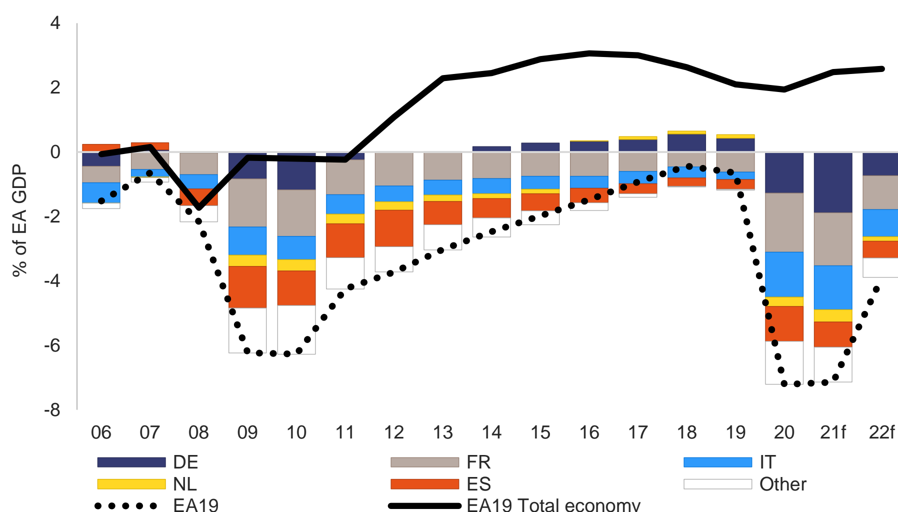
Graph 1.3: **Euro area current account by countries; and net lending and borrowing by sectors**



Notes: panel (b) For years before 2021, the euro area Total economy figures correspond to net lending/borrowing in the Eurostat BoP data. The euro area Total Economy figures for 2021 and 2022 correspond to the sum of European Commission autumn 2021 forecast of current account (adjusted) and capital account figures. Households and Corporations sector data for 2021 and 2022 are computed as the sum of the euro area countries except Malta, for which no data are available.
Source: Eurostat Balance of Payments, AMECO, and European Commission autumn 2021 economic forecast.

In 2020, the main changes to the external balances were sectoral rather than geographical. The current account surpluses of the largest contributors to the euro area surplus, Germany and the Netherlands (Graph 1.3 a), declined further in 2020. The positive contribution by Italy, as well as the negative contribution from France increased somewhat. The increase in the euro area surplus in the first half of 2021 was largely driven by a surge in the current account of Ireland. The contributions from Germany and the Netherlands to the euro area surplus also grew and returned to their 2019 levels. The share of Italy's surplus further increased and reached that of the Netherlands. The geographical composition of the euro area surplus is currently forecast to remain broadly stable going forward. By contrast, the sectoral contributions to the external balance changed substantially in 2020 (Graph 1.3 b). Increased savings by households and, to a lesser extent, corporations, were offset by strong expansionary fiscal policies. Private sector net lending is forecast to further expand in 2021, driven primarily by the corporate sector and despite a fall in precautionary savings and an increase in consumption by households. Government net borrowing is forecast to remain almost unchanged, with the large increase in the German deficit strongly contributing to the large euro area net government borrowing (Graph 1.4). Government positions are expected to narrow substantially in 2022 (see also Section 2.4 on the government sector). As a decline of similar magnitude is forecast for the private sector net lending, the external position is projected to remain stable.

Graph 1.4: **Geographical distribution of the euro area government sector net borrowing**



Note: For years before 2021, the EA19 Total economy figures correspond to net lending/borrowing in the Eurostat BoP data. The EA19 Total Economy figures for 2021 and 2022 correspond to the sum of European Commission autumn 2021 forecast of current account (adjusted) and capital account figures.
Source: Eurostat Balance of Payments and AMECO.

Policy response

The pandemic has highlighted the positive role of counter-cyclical discretionary fiscal policy, supportive monetary policies and European coordination in responding to the economic crisis. The COVID-19 crisis has shown that sizeable discretionary fiscal reactions can be effective in mitigating the immediate impact of a large shock, and successful in paving the way for a swift rebound. The immediate national fiscal effort was buttressed by the easing of the EU regulatory frameworks. The collective reaction fostered general economic confidence. Monetary policy measures contributed to preserving favourable financing conditions for all sectors of the economy throughout the pandemic, underpinning economic activity and safeguarding medium-term price stability. The mutually reinforcing effects of fiscal and monetary policies have been crucial for cushioning the impact of the crisis and supporting the recovery. While financing conditions are set to remain supportive, the low interest rate environment and the recent edging up of inflation limit the possibility for further monetary easing. Fiscal policy may thereby need to maintain a stabilisation role if downside risks emerge while prudent budgetary policy in normal times creates confidence in the effectiveness of budgetary policy in times of crisis.

Preventing and correcting macroeconomic imbalances remains essential. First, a weak economic recovery could cause a spike in corporate bankruptcies leading to job losses as well as increased calls on crisis-related guarantees for corporate loans and a retrenchment of investment. Second, adverse economic developments could accentuate the sovereign-bank loops. Third, booming asset and house prices could increase the vulnerability of the household sector due to unsustainable asset price booms. ([9]) These risks can adversely affect government debt sustainability, and limit the room for fiscal policy to respond to future challenges. Unwinding the build-up of vulnerabilities will also help consolidate the recovery and strengthen long-term growth. More similar economic structures and more synchronised business cycles will contribute to increasing the effectiveness of the common monetary policy.

Reducing the high levels of both government and private debt crucially depends on the recovery developing into a sustained expansion, which requires productive investment. The former hinges on a supportive policy stance during the recovery and a well-timed withdrawal of the extraordinary policy support taken over the crisis. The strength of the expansion depends on boosting the economic fundamentals, which requires the implementation of adequate reforms and investment. That is all the more important as a number of countries are marked by high public and private debt and relatively low potential GDP growth. That makes reducing their debt burdens more difficult and calls for a credible return to prudent medium-term positions when economic conditions allow.

In light of the interconnections among euro area economies, an appropriate combination of macroeconomic policies across Member States is needed in order to sustain the recovery, while correcting imbalances and addressing emerging risks. An economic expansion in euro area net-creditor countries, including through supportive demand conditions, would not only be beneficial for those countries themselves, but also for net-debtor countries, as higher growth in the euro area supports growth and deleveraging as well as the improvement in external positions in the latter group of countries. A withdrawal of the extraordinary policy support taken over the crisis timed to the adjustment needs would help in that respect. Marked and lasting improvements in productivity and competitiveness in net-debtor countries would also contribute to external rebalancing and help easing the debt burdens. An effective use of instruments put in place at euro area and EU level, with effective implementation of the necessary reforms and investment, would help fostering a durable recovery and strengthening resilience, including by addressing imbalances and emerging risks. It will be crucial that Next Generation EU financing is fully absorbed and channelled to the most productive uses. This would both strengthen the economic impact of the funds and prevent the risk of an excessive growth of non-tradable activities and external imbalances in countries where EU funds inflows account for a large share of GDP.

By promoting an investment-rich recovery and strengthening resilience, the effective implementation of reforms and investment under the RRF will contribute to macroeconomic stability. The effective implementation of the recovery and resilience plans will make the EU economy more sustainable, inclusive, resilient and better prepared for the twin transitions. It will also help mitigate

([9]) European Commission (2020), "Impact of macroeconomic developments on fiscal outcomes." *Report on Public Finances in EMU,* Institutional Paper, 133, Part III.

the risk of divergences within the EU as the RRF grants are targeted towards Member States with lower GDP per capita and hit the hardest by the COVID-19 crisis. By supporting potential growth, the implementation of the RRPs could improve debt sustainability, especially in Member States facing the highest fiscal risks and too high private debts. Moreover, in contrast to the years following the global financial crisis, higher public investment will support the post-pandemic recovery. RRF grants will fund high-quality investment projects and enable productivity-enhancing reforms, without giving rise to higher national deficit and debt ratios. These grants and other sources of EU financing are estimated to boost public investment in Member States by an average of about 0.5% of GDP per year in 2021 and 2022.

2. IMBALANCES, RISKS AND ADJUSTMENT: MAIN DEVELOPMENTS ACROSS COUNTRIES

2.1. A SNAPSHOT OF THE SCOREBOARD OUTCOMES

The AMR builds on an economic reading of the MIP scoreboard of indicators, which provides a filtering device for detecting *prima facie* evidence of possible risks and vulnerabilities. The scoreboard includes 14 indicators with indicative thresholds in the following areas: external positions, competitiveness, private and government debt, housing markets, the banking sector, and employment. It relies on data of good statistical quality to ensure data stability and cross-country consistency. In accordance with the MIP regulation (Regulation (EU) No 1176/2011), the role of the Commission is to undertake an economic reading of the scoreboard values that enables a deeper understanding of the overall economic context and taking into account country-specific considerations; the scoreboard indicators are not be read mechanically. ([10]) A set of 28 auxiliary indicators complements the reading of the scoreboard.

In addition, this report uses forecasts, nowcasts and high-frequency data to better gauge the possible evolution of risks for macroeconomic stability. The official AMR scoreboard contains data up to 2020. Given the significant uncertainty around the full impact of the COVID-19 crisis, this report includes a forward-looking assessment of the potential implications of the crisis for macroeconomic stability and the evolution of existing macroeconomic imbalances. That is in line with the approach pursued in the AMR published in November 2020. Values of scoreboard variables for 2021 and subsequent years have been estimated using Commission forecast data and nowcasts are based on in-year data (see Annex 1 for details). There is substantial uncertainty underlying those forecasts and it is necessary to bear this in mind in order to uphold the principles of transparency about analysis and data used, and prudence on the conclusions. In addition, as in previous years, insights from assessment frameworks, as well as findings in existing IDRs and relevant analyses, are also taken into consideration in the AMR assessment.

The scoreboard data suggest that the recent correction of stock imbalances has been interrupted with the COVID-19 crisis, while risks of overheating mainly related to housing markets may have become more widespread. Counting the instances of values outside the thresholds in the AMR scoreboard over the years reveals the following (Graph 2.1.1)

- The economic expansion between 2013 and 2019 helped reduce private and government debt-to-GDP ratios, which was reflected in a falling number of Member States exhibiting debt ratios beyond the thresholds until 2019. The COVID-19 crisis interrupted this reduction and more countries have recorded, or are expected to record, readings of private and government debt above the thresholds.

- Higher house prices have led to a growing number of country readings being above the relevant thresholds in recent years. That pattern became clearly more visible in 2020 with more countries exceeding the threshold.

- Unit labour cost (ULC) growth (based on cumulative changes over 3 years) had been above the thresholds in a number of cases before the COVID-19 crisis and ULC further grew sharply in 2020. This was mostly driven by a mechanical effect of a much lower productivity due to reduced activity in a context of significant labour hoarding. ULC growth is expected to slow down as the recovery should allow headline productivity to revive. Readings beyond the real effective exchange rate and export

([10]) On the rationale underlying the construction of the AMR scoreboard and its reading see European Commission (2016), "The Macroeconomic Imbalance Procedure. Rationale, Process, Application: A Compendium", European Economy, Institutional Paper 039, November 2016.

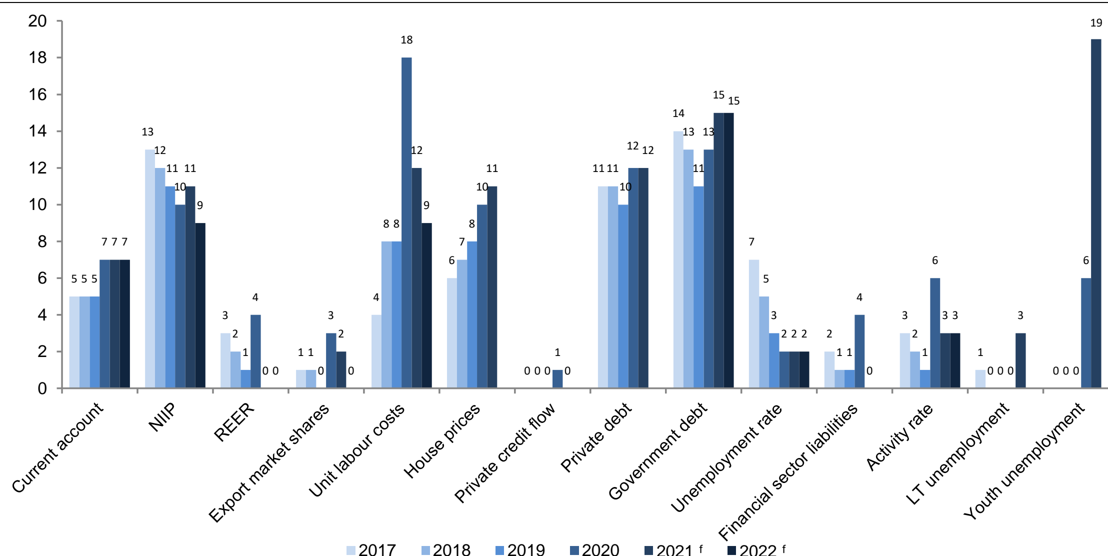
market share thresholds became more numerous in 2020 but are expected to unwind relatively quickly.

- A significant number of Member States has current accounts readings (based on 3-year averages) that continue to surpass either the upper or the lower thresholds. In recent years, there have been more countries with current account surpluses in excess of the upper threshold than countries with deficits beyond the lower threshold. The COVID-19 crisis has not fundamentally changed current account patterns, although a few more countries have marginally crossed the thresholds. ([11]) The recovery is expected to help reduce the number of cases of very negative net international investment positions in terms of GDP, which would mean a resumption of pre-pandemic trend of improving external positions.

- The crisis is showing an impact on the labour market. While unemployment rates have remained overall contained, activity rates have declined and crossed the respective threshold in a few Member States amid more people leaving the labour markets, which is also behind the more contained increases in headline unemployment rates. Long-term and especially youth unemployment are exhibiting their usual high sensitivity to changes in the labour market situation.

The rest of the AMR looks closely into these and other related issues.

Graph 2.1.1: **Number of Member States recording scoreboard variables beyond threshold**



Note: The number of countries recording scoreboard variables beyond relevant thresholds is based on the vintage of the scoreboard published with the respective annual AMR. Possible ex-post data revisions may imply a difference in the number of values beyond thresholds computed using the latest figures for the scoreboard variables compared with the number reported in the graph above. For the approaches followed for the forecasts of the scoreboard indicators in 2021 and 2022, see Annex 1. Forecasts for the following indicators are performed for 2021 only: House prices, Private credit flow, Private debt, Financial sector liabilities, Long-term unemployment, Youth unemployment.
Source: Eurostat and Commission services calculations (see Annex 1)

([11]) The increase in the number of Member States with current account readings outside the thresholds between 2019 and 2020 data vintages observed in Graph 2.1.1 is mostly due to data revisions.

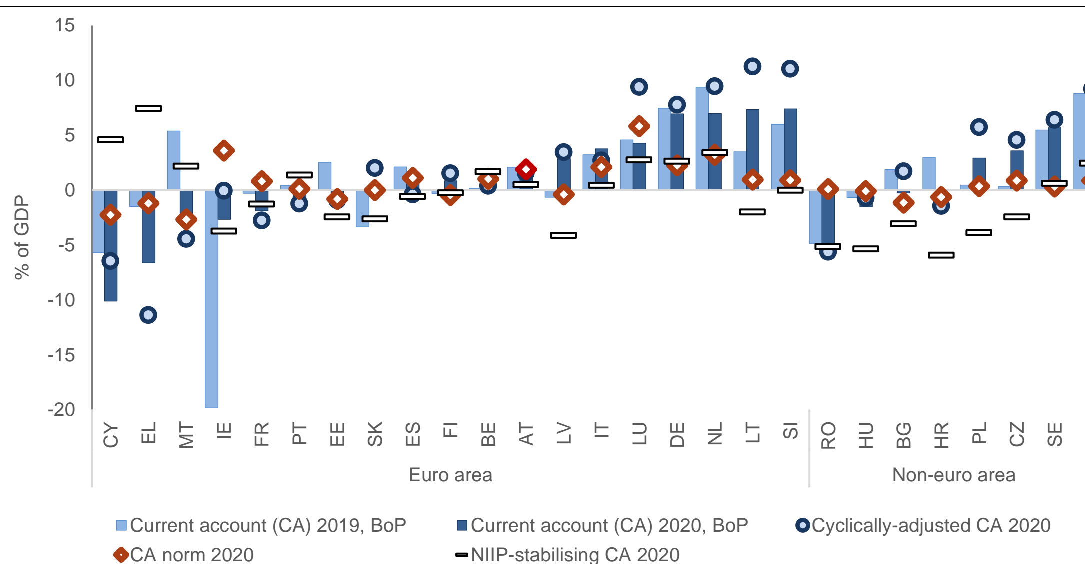
2.2. EXTERNAL SECTOR AND COMPETITIVENESS

2.2.1. EXTERNAL SECTOR

The current accounts of several Member States that have been marked by large stocks of external liabilities were adversely affected by the COVID-19 crisis, while the current account surpluses of several countries remained large. Across the EU, current account balances moved in different directions during 2020, with countries that rely heavily on exports of travel services experiencing strong deteriorations in their current accounts. This included Croatia, Cyprus, Greece, and Malta, and to a smaller extent, Portugal and Spain (Graph 2.2.1). With the exception of Malta, all of them were marked by large stocks of external liabilities before the COVID-19 crisis. Conversely, considerable improvements in current accounts have been recorded in Czechia, Latvia, Lithuania and Poland, mainly on account of higher trade balances, but also supported by rising investment income balances, amid reduced foreign investors' income in the crisis. Large current account surpluses have declined during the pandemic in Germany, Denmark and in particular in the Netherlands, but they remain sizeable. In the case of Slovenia, the current account surplus increased further. Lower energy prices during 2020 increased the current accounts of nearly all Member States.

While changes in external balances remained mostly limited and temporary given the magnitude of the economic shock, there has been a big shift in sectoral contributions to EU countries' external flows. Households increased their savings for precautionary reasons and because of limited consumption possibilities, while corporates typically reduced their investment amid uncertainty, leading to increases in the net lending/borrowing positions of private sectors (Graph 2.2.3 a, b and c). Conversely, governments intervened to support the economy in the crisis, while simultaneously facing lower revenues, leading to large government net borrowing in all EU countries. The large sectoral swings broadly offset each other and so did not induce substantial changes in the countries' overall net lending/borrowing positions in most Member States.

Graph 2.2.1: **Current account balances and benchmarks in 2019 and 2020**



Note: Countries are ranked by current account balance in 2020. Current account norms: see footnote 12. Cyclically-adjusted current account balances: see footnote 15. The NIIP-stabilising current account benchmark is defined as the current account required to stabilise the NIIP at the current level over the next 10 years or, if the current NIIP is below its country-specific prudential threshold, the current account required to reach the NIIP prudential threshold over the next 10 years.
Source: Eurostat and Commission services calculations.

The current accounts of three Member States were below the lower MIP scoreboard threshold, which reflects the three-year average, in 2020. The large current account deficit of Cyprus continued deteriorating in 2020 reaching -10.1% of GDP mainly on account of reduced international tourism but

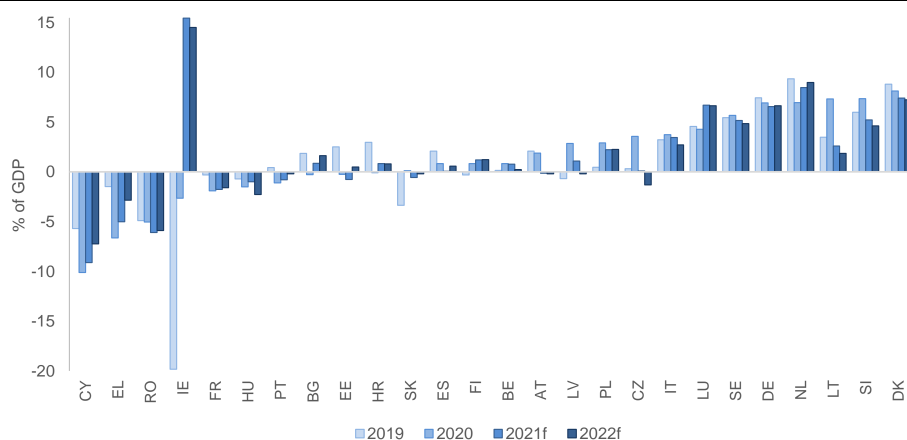
also due to deepening of the primary income balance deficit. Its three-year average moved further below the MIP threshold. The current account is below its norm as well as below the level required to bring the NIIP at the prudential benchmark over the next 10 years. ([12]) ([13]) The current account of Romania maintained its steady downward trend by recording a marginal decline to -5% of GDP, which slightly increased the gap to the respective norm. While the current account of Ireland equalled -2.7% of GDP in 2020, the 3-year average came out close to -6%, driven by an exceptionally large deficit in 2019. ([14])

In 2020, four Member States had current account surpluses exceeding the upper MIP threshold. That has been the case for Denmark, Germany, and the Netherlands for nearly a decade. The surpluses in Denmark and Germany equalled 8.1% and 6.9% of GDP respectively in 2020, down compared with 2019, and the surplus of the Netherlands fell from 9.4% to 7% of GDP, driven also by the activities of multinational corporations. While the Danish surplus declined as a result of a lower trade balance, in Germany and the Netherlands falls were driven mainly by a lower investment income balance. The high surplus in Slovenia expanded from 6% to 7.4% of GDP during the crisis, amid higher trade and primary income balances. Surpluses in all four countries remained substantially above their respective current account norms and the NIIP-stabilising current account benchmarks.

The current accounts of most other EU countries exceeded their country-specific levels suggested by fundamentals in 2020, with some notable exceptions. Both headline and cyclically-adjusted current accounts were above, or close to current accounts justified by fundamentals, as well as above the NIIP-stabilising current accounts in most Member States (Graph 2.2.1). ([15]) Notable exceptions were Greece and Portugal, with current account outturns below both the norm and the balance needed to reach the prudential NIIP over 10 years. For both countries, and especially for Greece, the COVID-19 crisis caused a considerable decline in their current accounts, which had strengthened significantly in previous years.

The current account deficits of countries with substantial cross-border tourism sectors are forecast

Graph 2.2.2: **Evolution of current account balances**



Note: Countries are presented in increasing order of the current account balance in 2020.
Source: Eurostat, European Commission autumn 2021 economic forecast and Commission services calculations.

([12]) Current accounts in line with fundamentals ("current account norms") are derived from reduced-form regressions capturing the main determinants of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See L. Coutinho et al. (2018), "Methodologies for the assessment of current account benchmarks", European Economy, Discussion Paper 86/2018, for the description of the methodology for the computation of the fundamentals-based current account used in this AMR; the methodology is akin to S. Phillips et al. (2013), "The External Balance Assessment (EBA) Methodology", IMF Working Paper, 13/272.

([13]) NIIP prudential thresholds are determined from the maximisation of the signal power in predicting a balance of payment crisis, taking into account country-specific information summarised by per-capita income. For the methodology for the computation of NIIP prudential thresholds, see A. Turrini and S. Zeugner (2019), "Benchmarks for Net International Investment Positions", European Economy, Discussion Paper 097/2019.

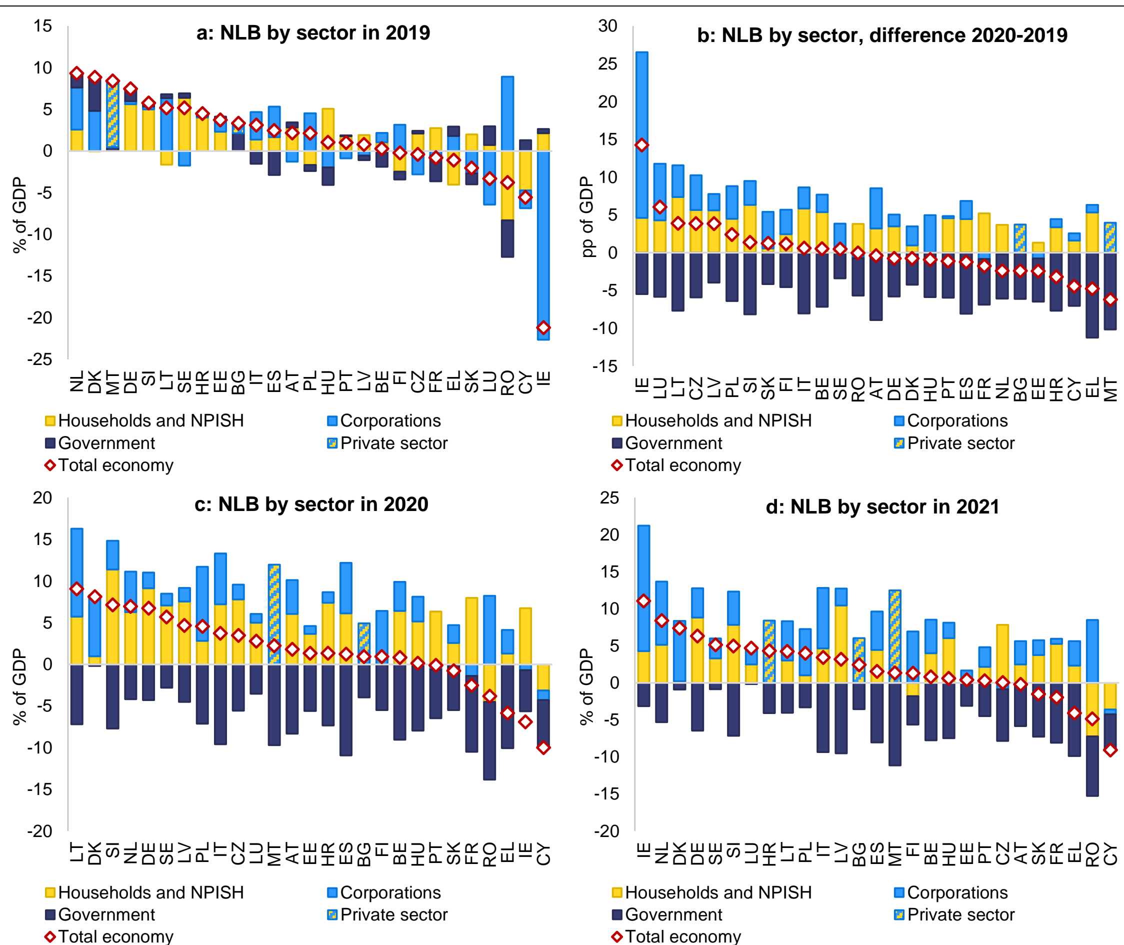
([14]) In 2019, the current account deficit amounted to -19.9% of GDP. Large volatility of external sector data for Ireland is strongly linked to activities of multinational enterprises.

([15]) Cyclically-adjusted current account balances take into account the impact of the cycle by adjusting for the domestic output gap and that in trading partners, see M. Salto and A. Turrini (2010), "Comparing alternative methodologies for real exchange rate assessment", European Economy, Discussion Paper 427/2010.

to slowly improve over 2021 and 2022, while the largest surpluses are mostly but not always expected to mildly decline (Graph 2.2.2). Going forward, a gradual recovery of international travel is expected, which could, however, be uneven and remain incomplete by the forecast horizon (see Box 1 on tourism). It will lend support to improvements in the current accounts of countries strongly relying on tourism exports, most notably Croatia, Cyprus and Greece. Yet the large current account deficit of Cyprus is expected to improve only slowly. The current account of Romania is forecast to further worsen. Conversely, the volatile current account of Ireland is projected to record large surpluses over the forecast period. The large surpluses of Denmark, Germany and Slovenia are forecast to decline, even if only very mildly in the case of Germany, while the surplus of the Netherlands is forecast to rebound to nearly its 2019 level by 2022.

From the savings and investment perspective, the contribution of different sectors to external positions is not expected to change substantially in most Member States. While private sectors are expected to mostly remain net lenders, governments are projected to stay net borrowers in 2021 (Graph 2.2.3 d). Within private sectors, the net lending positions of corporations are forecast to increase in most Member States, and that of households to decline somewhat. On average, governments' net borrowing is expected to decrease mildly. Within public sectors, the net lending positions of Member States with a high current account surplus will have an impact on their external position.

Graph 2.2.3: **Net lending/borrowing by sector in 2019-2021**

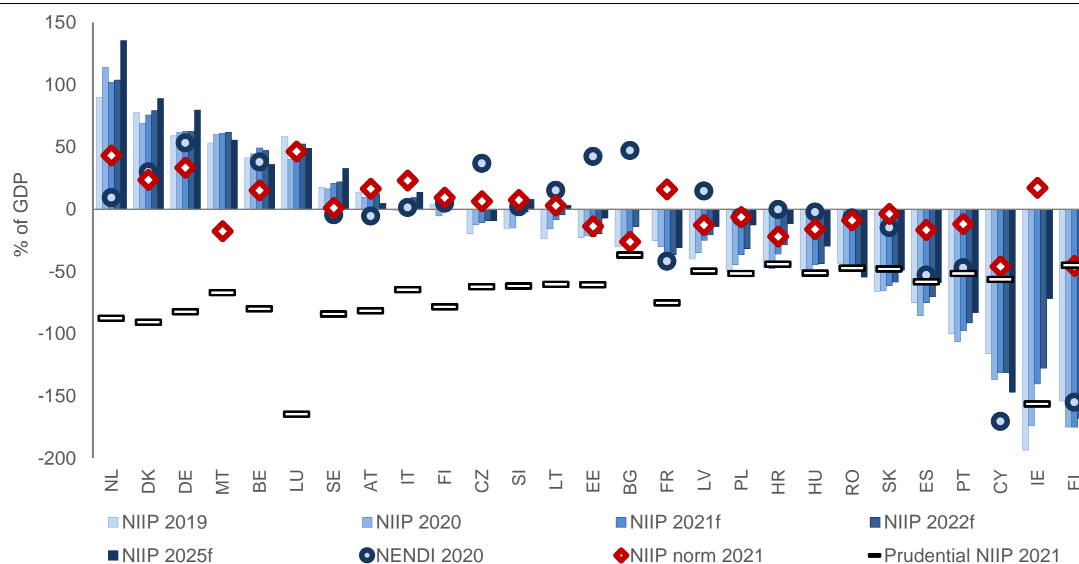


Source: AMECO and European Commission autumn 2021 economic forecast.

During 2020, the net international investment positions (NIIPs) worsened in most large net-debtor countries, while they mostly improved in those with large positive positions. After having increased in all but four EU countries in 2019, there were considerable cross-country differences in NIIP developments during 2020, with the NIIPs of nearly half of the Member States declining. In 2020, there were ten EU countries with NIIPs below the scoreboard threshold of -35% of GDP, one less than in 2019. In all those cases, for 2021, their positions are expected to remain lower than the NIIPs suggested by

fundamentals, and in six of them the NIIPs are projected at levels below the prudential thresholds (Graph 2.2.4). ([16]) Large negative NIIPs are mainly forecast to improve. In the medium term, three Member States with NIIPs below the -35% mark in 2020 are expected to surpass it. Large positive NIIPs are projected to further increase or remain broadly stable.

Graph 2.2.4: **Net international investment positions (NIIP) 2019-2022, 2025, and benchmarks in 2021**



Note: Countries are presented in decreasing order of the NIIP-to-GDP ratio in 2020. NENDI is the NIIP excluding non-defaultable instruments. For the concepts of NIIP prudential threshold and NIIP norm, see footnotes 13 and 16. NENDI for IE, LU and MT are out of scale.
Source: Eurostat and Commission services calculations (see also Annex 1).

The Member States with the largest negative NIIPs experienced the strongest declines during 2020 but the recovery is expected to allow improvements in most cases. Cyprus, Greece, Ireland, and Portugal have NIIPs below -100% of GDP and below their fundamental and prudential benchmarks. They are followed by Spain with an NIIP of around -85% of GDP. With the exception of Ireland, these Member States experienced strong deteriorations in their positions, which in the case of Cyprus and Greece amounted to around 20 percentage points of GDP. The main drivers were the nominal GDP declines, in particular in Greece, and the large current account deficits, especially in Cyprus. In Ireland, as well as in Cyprus, NIIP levels largely reflect cross-border financial relations of multinational enterprises and of special purpose entities. All those five countries are characterised by comparatively large negative NIIP excluding non-defaultable instruments (NENDI), i.e. large shares of net debt liabilities in their external position. ([17]) Most of the external liabilities of Greece is composed of public debt at concessional terms. External sustainability of some Member States with large negative NIIPs will be supported by, sometimes sizeable, inflows of grants under the Recovery and Resilience Facility (RRF), in addition to EU transfers under the Multiannual Financial Framework (MFF). Still, current projections suggest stagnation of Cyprus' NIIP, even in the medium term. Conversely, the NIIPs of other countries with large negative NIIPs should gradually improve towards 2022 and over the medium term, on the back of strong GDP growth and improved current accounts, with the expected progress being exceptionally swift in the case of Ireland, amid large forecast current account surpluses.

Most of the EU countries with moderately negative NIIPs did not experience large changes in their positions in 2020 and forecasts suggest improvements in most of them going forward. All of these

([16]) NIIP in line with fundamentals (NIIP norms) are obtained as the cumulation over time of the values of the current account norms (see also footnote 12). For the methodology for the computation of NIIP stocks in line with fundamentals, see A. Turrini and S. Zeugner (2019), "Benchmarks for Net International Investment Positions", European Economy, Discussion Paper 097/2019.

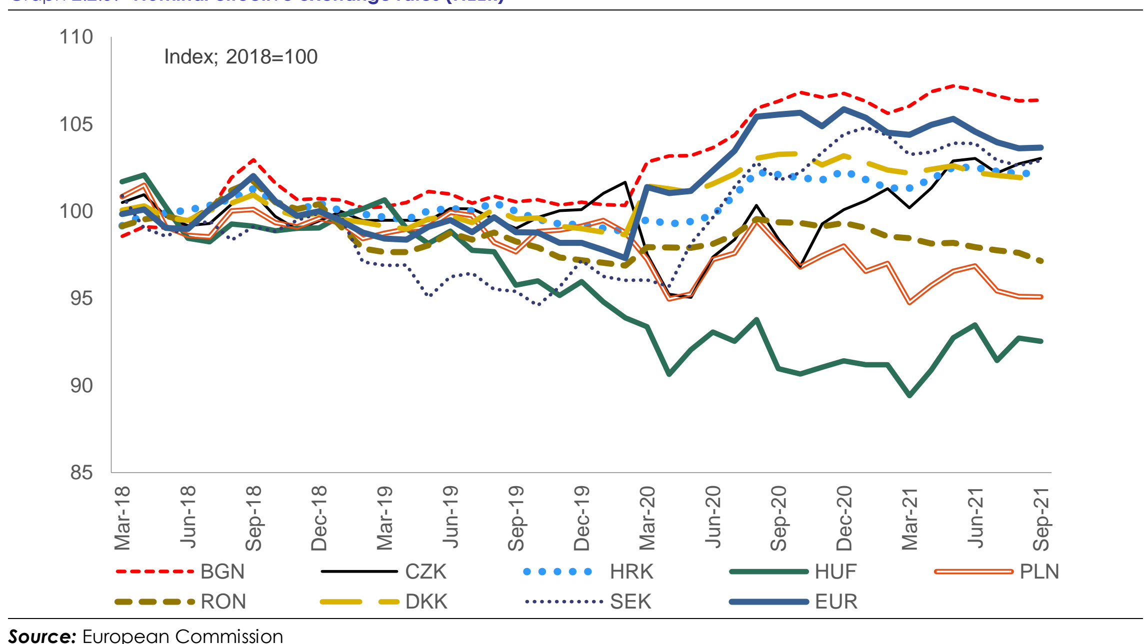
([17]) NENDI is a subset of the NIIP that abstracts from its pure equity-related components, i.e. foreign direct investment (FDI) equity and equity shares, and from intracompany cross-border FDI debt, and represents the NIIP excluding instruments that cannot be subject to default. See also European Commission, "Envisaged revision of selected auxiliary indicators of the MIP scoreboard", Technical note; https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/macroeconomic-imbalance-procedure/scoreboard_en.

countries, Croatia, Hungary, Poland, Romania, and Slovakia, are expected to have NIIPs below their fundamental benchmarks in 2021, but only the NIIPs of the latter two Member States are forecast at levels below prudential thresholds. The NIIPs of all these Member States, as well as of other central and eastern European and Baltic countries, are characterised by large stocks of inward foreign direct investment, and NENDIs that are much more favourable than their NIIPs. In addition, these countries are comparatively large recipients of EU transfers under the MFF, which lends non-negligible support to their external positions. The RRF grants that come on top of the MFF transfers further underpin increases in the NIIPs of most of these countries. Overall, forecasts suggest improvements in the NIIPs of these countries going forward, with the exception of Romania whose position is expected to mildly deteriorate (Graph 2.2.4).

Diverging developments in 2020 have been recorded also within the group of Member States with large positive NIIPs. The NIIPs of the Netherlands, Germany, Malta, and Belgium expanded further, on the back of the continued sizeable current account surpluses for the first two countries, and in all four cases helped by the decline in nominal GDP. In particular, the Netherlands, but also Malta, recorded also strong positive valuation effects. Conversely, negative valuation changes limited the increase in the German NIIP. Large positive NIIPs of Denmark and Luxembourg declined amid negative valuation changes, despite strong current account surpluses in the latter two countries.

External financing conditions may tighten going forward, which could have consequences for some non-euro area countries. At the onset of the COVID-19 crisis, global financial market tensions were felt in several non-euro area countries. At the time, currencies of some non-euro area Member States, most notably Hungary's forint, were under pressure and depreciated in March and April 2020 but recovered and stabilised already in May (Graph 2.2.5) as the global risk sentiment improved and capital flows stabilised. Some renewed capital flows volatility or tightening of external financing conditions cannot be excluded going forward, partly in anticipation of monetary tightening in the USA and other advanced economies. In this context, non-euro area countries with forecast large net lending positions are less exposed to external (re-)financing risks if these would re-emerge, as are the Member States with substantial foreign exchange reserve stocks. External financing needs, both of the private and the government sectors, also play a role in this context (see section 2.4 on the government sector).

Graph 2.2.5: **Nominal effective exchange rates (NEER)**



Source: European Commission

2.2.2. COMPETITIVENESS

Unit labour costs rose across the EU as a result of marked temporary reductions in headline labour productivity over the COVID-19 crisis. The scoreboard shows ULC growth, based on cumulative growth over the three years to 2020, above the threshold in 18 Member States, compared to eight countries one year ago. Prior to 2020, signs of potential overheating pressures existed in some countries, including Bulgaria, Czechia, Estonia, Hungary, Latvia, Lithuania, Luxembourg, Malta, Romania and Slovakia. In 2020 alone, ULC growth accelerated in 22 Member States. However, this exceptional ULC growth is projected to be partially reversed in many countries in 2021 and 2022, amid generally increased ULC volatility.

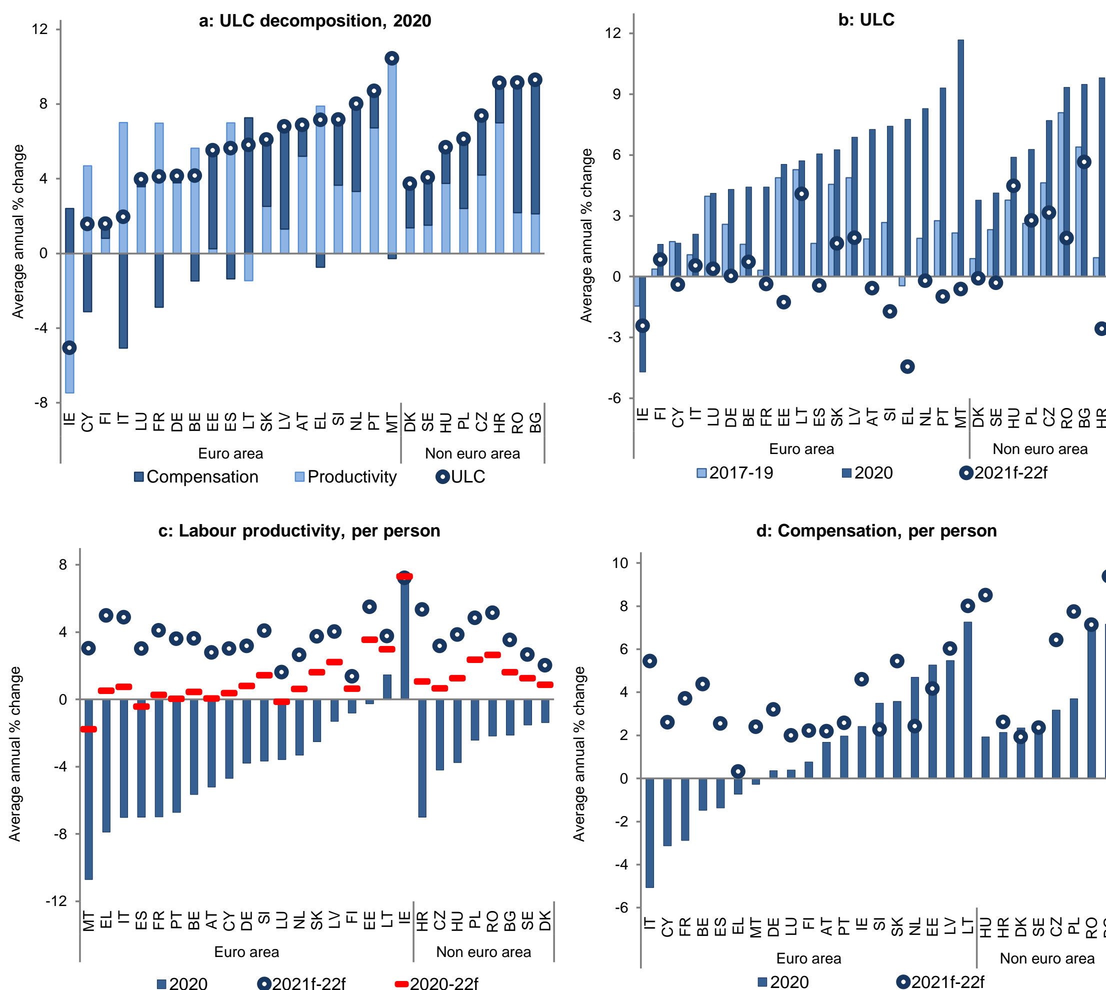
The impact of the COVID-19 pandemic and structural frictions emerging in the recovery makes changes in cost competitiveness difficult to assess. The sharp acceleration in ULC growth in 2020 and its expected partial reversal in most countries in 2021 and 2022 is dominated by a statistical effect due to extensive labour hoarding and the subsequent fall in headline per capita productivity (Graph 2.2.6). This was induced by the government support to job retention schemes, mainly in the form of temporarily expanded short-time work schemes, which favoured a reduction in hours worked rather than impacting employment levels. The combination of labour market slack and skill shortages point to volatility and uncertainty about ULC developments going forward. These are linked to supply chain issues and frictions from the uneven economic recovery, as well as the accelerated digital transformation and longer term structural changes. Given that recent years have been marked by high ULC growth for many countries, cost competitiveness losses remain a risk to be watched, notably to grasp the extent to which the losses recorded in 2020 can be recouped over the recovery. Policies to promote competitiveness and productivity remain highly important for a sustainable recovery from the COVID-19 crisis.

Labour productivity fell in almost all EU countries in 2020, but it is expected to recover this year and next (Graph 2.2.6 c). Labour inputs decreased during the COVID-19 crisis, mainly on account of reduced hours, while headcount employment moved little, supported by government measures including expanded short-time work schemes, the use of which has declined significantly over the recovery. As a result, labour productivity based on the number of employees declined stronger as compared to labour productivity based on hours worked in most countries. In 2021 and 2022, as the recovery sets in and labour hoarding effects are reversed, an upward jump in productivity figures is expected. In 2022, productivity per person is forecast to be above its 2019 level in all Member States, except in Luxembourg, Malta, Portugal and Spain.

Wage increases were moderate in 2020, but are expected to pick up, sometimes markedly, in 2021 and 2022. Wage growth was subdued in most EU countries during the COVID-19 crisis (Graph 2.2.6 d). Compensation per employee is forecast to increase at an annual rate of over 5% in Bulgaria, Czechia, Hungary, Italy, Latvia, Lithuania, Poland, Romania and Slovakia in 2021 and 2022. For Belgium, Estonia and Ireland, the increases should average between 4% and 5%. In Bulgaria, Czechia, Estonia, Hungary, Latvia, Lithuania, and Romania and Slovakia, persistently high wage and ULC growth was already a concern before the pandemic, raising questions about cost competitiveness.

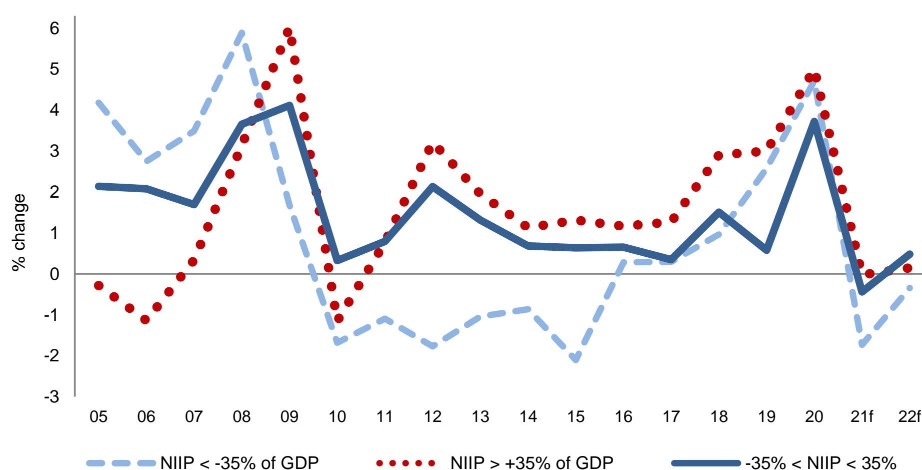
Across the euro area, ULC developments should return to supporting external rebalancing when the productivity effects have cleared. ULC growth in 2020 was stronger in some net-debtor countries, such as Greece, Portugal and Spain as they recorded sharper recessions and substantial labour hoarding. By 2022, the change in ULC growth will once again have become more supportive of external rebalancing, as it is forecast to be slightly lower in net-debtor than net-creditor ones (Graph 2.2.7). The more limited impact on rebalancing compared to the pre-pandemic time was affected by the lingering impact on productivity, which would need to be addressed to overcome existing divergences. Conversely, employee compensation is forecast to be higher in net-creditor than in net-debtor countries.

Graph 2.2.6: **Unit labour cost, compensation and productivity growth**



Note: Growth rates over multiple years are annualised.
Source: AMECO and European Commission autumn 2021 economic forecast.

Graph 2.2.7: **Unit labour cost growth across the euro area**



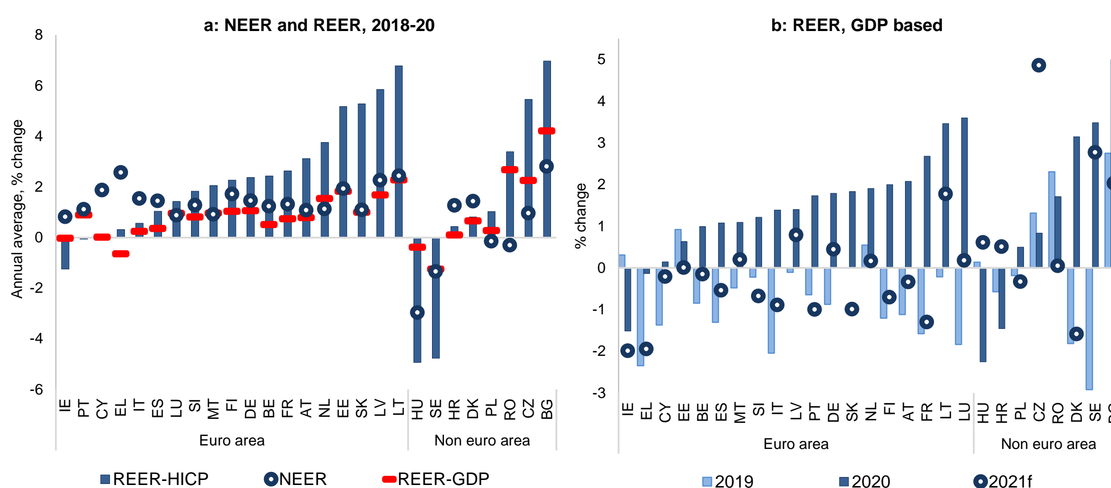
Note: Countries with NIIP > +35% of GDP are DE, LU, NL, BE, MT. Countries with NIIP between 35% and -35% of GDP are FI, EE, IT, LT, FR, SI, AT. Remaining countries are in the NIIP < -35% of GDP group. The country split is based on NIIP average values in the 2017-2019 period. Net-creditor countries recorded an average current account surplus over the same period. Figures concern GDP-weighted averages for the three groups of countries.
Source: AMECO and European Commission autumn 2021 economic forecast

Nominal effective exchange rates appreciated in most countries in 2020. The strongest appreciations were recorded for Bulgaria, Greece, Latvia, Lithuania and Sweden. Only Hungary, and to a lesser extent, Czechia and Poland recorded nominal depreciations. The appreciation in nominal effective exchange rates reflects also the appreciation of the euro at the onset of the COVID-19 pandemic and the associated flight to safe haven. In 2021 so far, nominal effective exchange rates have appreciated in most EU countries, although in most cases more moderately than in 2020.

HICP-based real effective exchange rates (REERs) appreciated moderately in most Member States in 2020 which partly reflects nominal appreciations. The only countries that witnessed a depreciation of the HICP-based REER were Croatia and Hungary. The strongest appreciations were recorded in Bulgaria, Lithuania and Sweden. This moderate appreciation follows a depreciation witnessed in most Member States in 2019. Going forward, the GDP-deflator-based REER, for which forecasts are available for 2021, suggests that real exchange rates can be expected to increase moderately, with notable appreciations only in Bulgaria, Czechia, Lithuania and Sweden (Graph 2.2.8 b).

REER developments are supportive of external rebalancing, but only to a limited extent. Some net-creditor countries, including Denmark, Germany, the Netherlands and Malta exhibited a REER appreciation slightly above the EU average in 2020. Some large net-debtor countries or countries that have been more affected by the COVID-19 recession, such as Cyprus, Croatia, Greece, Italy, Portugal or Spain, recorded some competitiveness gains vis-à-vis those net-creditor countries thanks to lower inflation, as suggested by more moderate REER developments (Graph 2.2.8). This tendency seems to also persist in 2021, suggesting that REER developments remain moderately supportive of external rebalancing in the near-term.

Graph 2.2.8: **Nominal and real effective exchange rates (NEER and REER) dynamics**



Note: The REERs and the Nominal Effective Exchange Rate (NEER) are computed vis-à-vis 42 trading partners.
Source: AMECO and European Commission autumn 2021 economic forecast.

Export market shares fluctuated strongly in 2020 and three Member States recorded losses beyond the scoreboard threshold. Based on the cumulated change over five years, France, Greece and Spain recorded substantial export market share losses in excess of the threshold. In contrast, many countries also recorded substantial gains, in the case of Ireland, Lithuania and Poland beyond 30 percent. Export market shares fluctuated strongly in 2020. EU countries, on average, gained some export market shares in 2020 alone, but with strong differences across countries.

Some countries with important export market share losses in 2020 are expected to recover only part of the losses in the near future. Apart from in Austria and Estonia, the sharp drop in the services balance in the context of the COVID-19 crisis stopped in recent quarters in Bulgaria, Croatia, Cyprus, Greece, Hungary, Italy, Malta, Portugal and Spain. The services trade balance of Germany remains slightly in surplus, after a sharp improvement since the beginning of 2020. Trade balances in goods developed more favourably in several countries since 2019 and partly offset the decline in the service trade balance. Export market shares are expected to increase particularly strongly in Croatia and Greece and Spain in

2021 and 2022, as cross-border travel recovers, but not in all cases enough to recover all losses witnessed in 2020. Overall, for the period 2020-2022, export market shares are expected to increase most in Estonia, Ireland, Lithuania, Luxembourg and Poland, and to decrease in Greece, Spain, France, and Portugal.

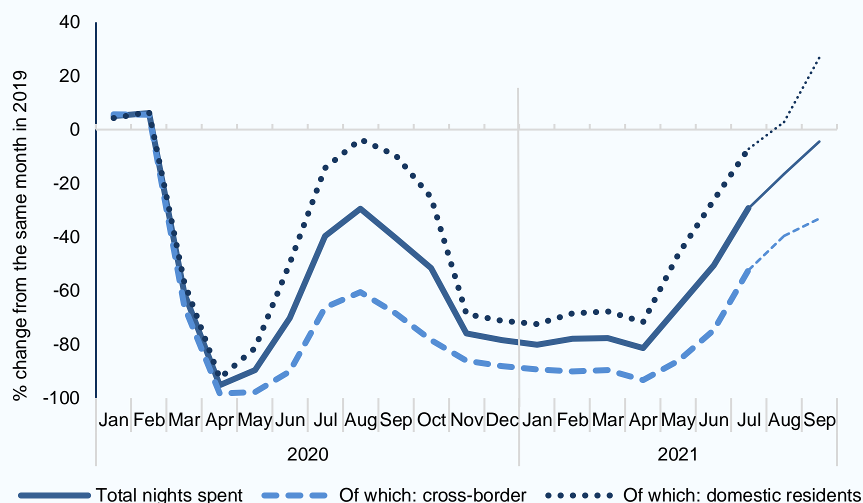
Export market share developments may contribute to some external rebalancing going forward. Countries with large current account surpluses, including Denmark, Germany and the Netherlands, are expected to lose, export market shares over the period 2020-2022. Data for the second quarter of 2021 continue to show service balance surpluses, in percentage of GDP, amidst strengthening goods trade balances in Germany and the Netherlands. Nonetheless, these countries will likely lose part of the export market share gains in services from the COVID-19 period as tourism flows recover.

Box 1: Tourism during the COVID-19 crisis

Tourism was one of the most heavily affected economic activities in the COVID-19 crisis, as the measures to contain the pandemic included restrictions in the hospitality sector and on international travel. The magnitude of the adverse impact is reflected in the large fall of nights spent by tourists (Graph 1): in April 2020, the number of nights spent in tourist accommodations dropped by 95% as compared to the same month in 2019. A substantial recovery was recorded in the summer months, as domestic tourism came close to 2019 levels in August 2020. Conversely, at the August peak, cross-border tourist nights remained 60% below their level in August 2019. With the second wave of the pandemic, travel activity declined again.

A recent, stronger recovery, including in cross-border tourism, started in May 2021. It followed substantial progress in vaccination and in the coordination on cross-border travel rules within the EU, through the introduction of the *EU Digital COVID Certificate*. Both domestic and cross-border tourism increased in July, as compared to 2020 level, with the latter improving more strongly. Taking also nowcasts for August and September into account suggests that overall tourism activity in summer 2021 increased by around 30% as compared to 2020, but still remains 16% below the 2019 levels, with some compositional changes. ([1]) While domestic tourism seems to have exceeded the levels attained in summer of 2019 during the summer months of 2021, especially in September, cross-border travel still lags behind the pre-pandemic levels by more than 40%. Comparing the first nine months of 2021 with the same period in 2020, shows that tourism performance in 2021 grew only by some 12%, partly reflecting the fact that the first quarter of 2020 was largely unaffected by the pandemic.

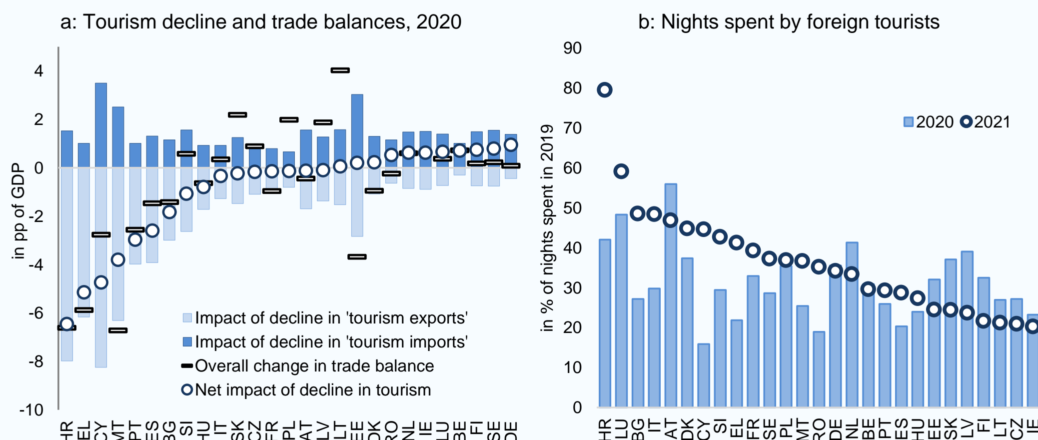
Graph 1: **Tourist nights spent in the EU in 2020 and 2021**



Note: Number of nights spent in tourist accommodation reported via Eurostat and augmented by nowcasts based on AirBnB-reviews for August and September 2021. Estimates for Cyprus, France and Ireland rely on the data from national statistical institutions. See also footnote 1.
Source: Eurostat and European Commission estimates.

Member States that rely strongly on exports of travel services were hit especially hard as cross-border travel plunged with the pandemic. The large fall in international tourism had a particularly strong impact on some net-debtor countries, such as Croatia, Cyprus, Greece, Portugal or Spain, that have been recording large surpluses in trade of travel services, as well as for Malta (Graph 2 a). ([2]) For most of these countries, the impact of the decline of international tourism on trade balances broadly accounts for the deterioration in their overall trade balances during 2020. ([3]) ([4]) The negative effects on large exporters of tourism services are gradually reversing in 2021, as the recovery of cross-border tourism gained momentum. At the other end of the spectrum are countries which normally import more travel services than they export. For them, the reduction in international travel had a partial positive effect on their trade balances, as tourists turned to domestic destinations.

Graph 2: **Impact of tourism decline on trade balances, and nights spent projections for 2021**



Notes: (a) The estimated effects refer only to trade in services recorded under the travel item in the Balance of Payments statistics. They are based on partial-equilibrium analysis, which uses trade in value-added data, and accounts for direct and indirect effects. See footnotes 3 and 4. (b) Projections for 2021 are based on the number of nights spent in tourist accommodation by non-residents, reported via Eurostat and augmented by nowcasts based on AirBnB-reviews in case of missing data, up to September. Estimates for Cyprus, France and Ireland rely on the data from national statistical institutions. For the last quarter of 2021, the projection assumes the same level of tourism activity as in the data (and nowcast) of the third quarter of 2021, in percentage of 2019 nights spent.
Source: Eurostat and European Commissions estimates.

Preliminary data on 2021 indicate a partial and gradual recovery in international tourism, which nonetheless varies across countries. The number of nights spent in tourism accommodations by foreign tourists in 2021 is projected to increase substantially in Croatia, Cyprus and Greece, and somewhat less in Spain (Graph 2 b). ([5]) At the same time, a rebound of international tourism activity in Portugal seems more muted, but the level remains slightly above the level projected for Spain. Significant increases in cross-border tourism are projected also for Bulgaria, Italy, Romania and Slovenia and while for e.g. Austria and the Netherlands, along with a few other Member States, declines are expected, likely reflecting different seasonal distributions of foreign tourists' visits, as well as the travel diversion effects during 2020 and 2021.

([1]) For details about the AirBnB data, and for methodological explanations of nowcasts see European Commission, European Economic Forecast Autumn 2020, 'Tourism in pandemic times: an analysis using real-time big data', Special Topic 3.3. Institutional Paper 136, November 2020. The nowcasts use the language of each review as a proxy to differentiate between nights spent by domestic tourists and by foreign residents.

([2]) The term 'international tourism' is used to denote international trade in travel services recorded under the travel item in the Balance of Payments statistics.

([3]) Estimates of the impact from the decline in international travel on trade balances are based on a partial-equilibrium analysis, which focuses on trade in value-added terms by accounting for imports of inputs used in production of goods and services consumed by foreign tourists. The analysis accounts for both the direct and indirect effects of the change in foreign tourist demand, i.e. also the backward linkages to sectors of the economy not directly affected by the tourist demand. The analysis assumes that the money not spent for travel abroad is saved. For more details see: L. Coutinho, G. Vukšić and S. Zeugner (2021), "International tourism decline and its impact on external balances in the euro area", *Quarterly Report on the Euro Area*, DG ECFIN, European Commission, Vol. 20, No 2, Part III.

([4]) A partial example is Cyprus where high net imports of services of international transport of passengers reduced strongly in 2020, cushioning the overall impact on trade balance. International transport of passengers is a separate category in the Balance of Payments, but is related to international tourism. As 2020 data on these services are not available for many EU countries, it is not included in the analysis. Among other countries for which data is available, accounting for this category does not significantly alter the results. In Malta, the trade balance was comparatively strongly impacted also by changes in items other than travel.

([5]) When comparing 2021 (projections) with the whole 2020, it should be reminded that nearly the whole first quarter of 2020 was not affected by the pandemic and that tourism activity was then on the rise as compared to 2019.

2.3. PRIVATE DEBT AND HOUSING MARKETS

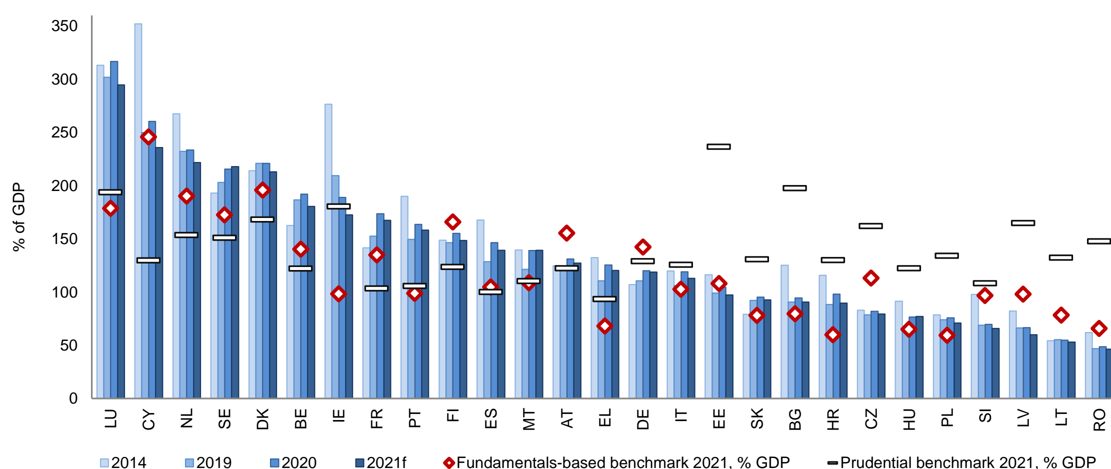
2.3.1. PRIVATE DEBT

Private sector debt ratios increased markedly with the COVID-19 crisis but are forecast to return to their declining trend in 2021 in most countries. In 2020, the private sector debt-to-GDP ratio increased in all EU countries, except Denmark, Ireland and Lithuania (Graph 2.3.1), interrupting the deleveraging that was underway in many countries. The increase in 2020 was principally due to the decrease in GDP but borrowing also increased in most countries, particularly for corporates. Credit guarantees and debt repayment moratoria were important policy measures to overcome liquidity shortages at the beginning of the COVID-19 crisis, but have also contributed to the debt increase. Private sector debt-to-GDP ratios exceeded the scoreboard threshold of 133% of GDP in 12 Member States (Belgium, Cyprus, Denmark, Finland, France, Ireland, Luxembourg, Malta, the Netherlands, Portugal, Spain and Sweden), compared to 10 countries one year ago, when Spain and Malta were below (Graph 2.3.1). There were marked increases for other Member States which stayed below the threshold. Total private debts stocks appear high when compared with benchmarks that account for country-specific economic fundamentals and with thresholds that account for prudential concerns. ([18]) This is the case for Belgium, Cyprus, Denmark, France, Greece, Ireland, Luxembourg, Malta, the Netherlands, Portugal, Spain and Sweden.

Overall, the COVID-19 crisis has increased risks associated with private debt levels. With the economic recovery, private debt-to-GDP ratios are forecast to start declining in 2021 across the EU (Graph 2.3.1). Nonetheless, they are expected to remain above their 2019 levels in most EU countries. As government support measures are phased out, firms' and households' ability to meet their repayment obligations may be compromised, especially sectors among those more severely hit by the COVID-19 crisis and where balance sheets were already weaker before the crisis, leading to a deterioration in debt quality. In addition, the rising debt levels by firms, households, governments and banks also led to higher interconnectedness between sectors, potentially accelerating the transmission of shocks across sectors. Disruptions to global value chains and frictions from the uneven economic recovery, in a context of accelerated digital transformation, pose risks and induce structural changes and a churning of firms and jobs.

([18]) Country-specific debt benchmarks have been developed by the European Commission in cooperation with the EPC LIME Working Group (European Commission, "Benchmarks for the assessment of private debt", Note for the Economic Policy Committee, ARES (2017) 4970814) and J.-C. Bricongne, L. Coutinho, A. Turrini and S. Zeugner, "Is Private Debt Excessive?", *Open Economies Review*, 3, 471-512, 2020. Fundamentals-based benchmarks allow assessing private debt against values that can be explained on the basis of economic fundamentals, and are derived from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. Prudential thresholds represent the debt level beyond which the probability of a banking crisis is relatively high; those levels are based on the maximisation of the signal power in predicting banking crises by minimising the probability of missed crisis and of false alerts and incorporating country-specific information on bank capitalisation, government debt, and level of economic development.

Graph 2.3.1: **Private debt**



Source: Eurostat, AMECO, European Commission autumn 2021 economic forecast, and Commission services estimates for private debt in 2021 (see Annex 1). Debt comprises loans (F4) and debt securities (F3).

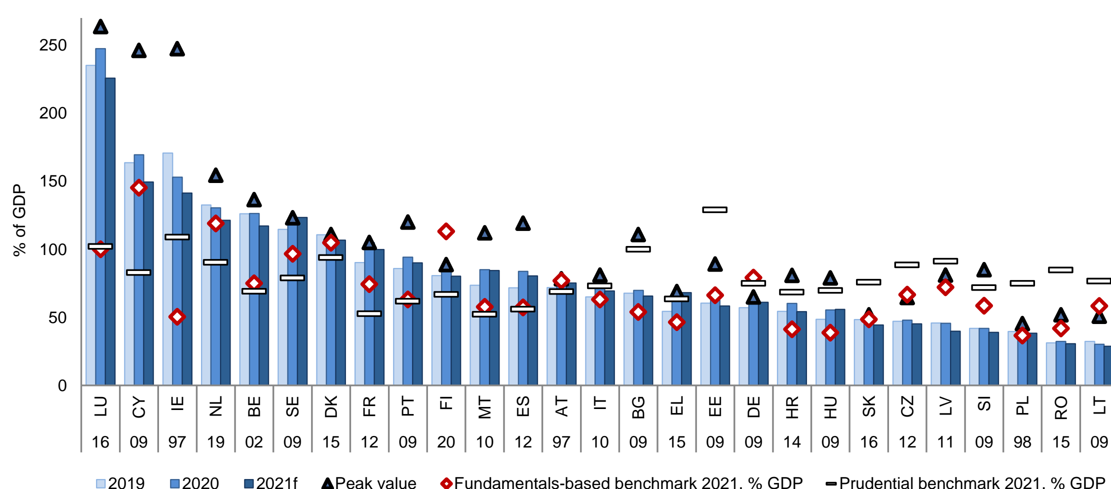
2.3.1.1. Debt of non-financial corporations

Corporate indebtedness increased in most EU countries in 2020, sometimes sharply. In 2020, the corporate debt-to-GDP ratio increased in 19 countries, largely due to the sharp drop in GDP. However, net corporate credit flows also contributed to the increase, in light of marked revenue losses and perceived liquidity shortages in 2020, which also contributed to a strong increase in corporate deposit holdings. Non-financial corporations' (NFC) debt-to-GDP ratios increased particularly strongly in a number of countries with already high corporate debt levels or large tourism sectors that were hard hit by the recession (Graph 2.3.3 a). These countries include Cyprus, France, Greece, Italy, Malta, Portugal and Spain. Very high levels of corporate debt also continue to exist in Belgium, Ireland, Luxembourg and the Netherlands, although vulnerabilities are partly mitigated by a sizeable share of foreign direct investment loans and cross-border intracompany borrowing.

NFCs debt-to-GDP ratios remain high in many Member States and debt ratios were above levels suggested by both economic fundamentals and prudential thresholds in 14 countries in 2020. These are Belgium, Cyprus, Denmark, France, Greece, Ireland, Luxembourg, Malta, the Netherlands, Portugal, Spain, Sweden, and more marginally Austria and Italy (Graph 2.3.2). For most countries, NFC debt is below its previous peak, given the substantial deleveraging that has taken place in recent years, but the pandemic has undone some of this progress. For some countries, such as Austria, Belgium, Denmark, France, Finland, Germany, Greece, Italy, Luxembourg, Poland, Slovakia, and Sweden, corporate debt is at or very close to its highest level since the mid-1990s.

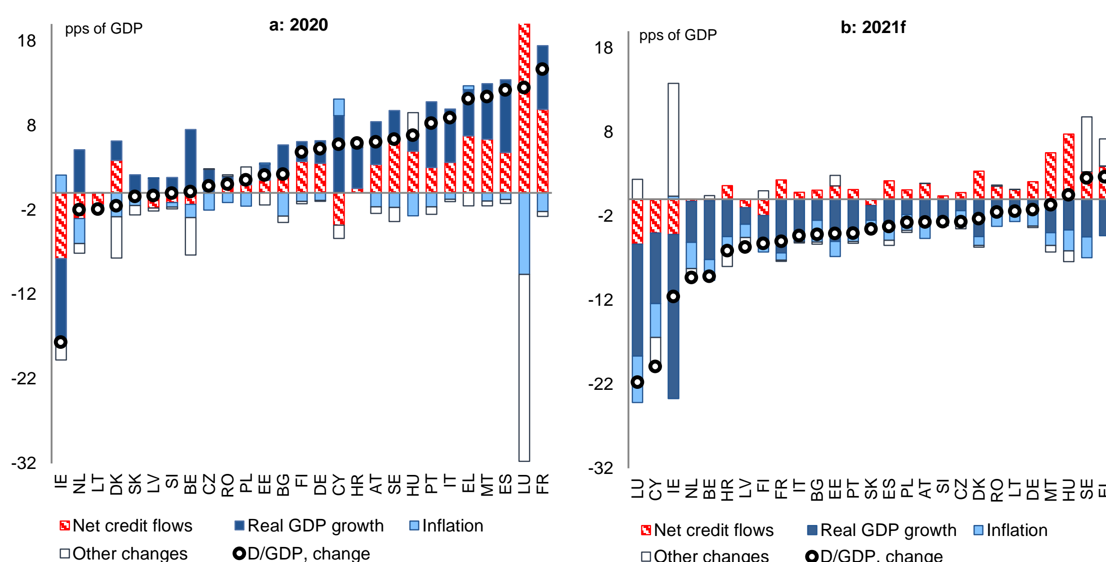
Going forward, the high nominal GDP growth will mechanically lower the debt-to-GDP ratio in 2021 and beyond, but starting from higher debt levels. The strong recovery of GDP makes corporate debt-to-GDP ratios likely to decrease – in some cases significantly – in 2021 in all EU countries, except Greece, Hungary and Sweden (Graph 2.3.3 b). Credit flows are expected to exceed their pre-pandemic levels in more than half of the Member States. The high nominal GDP growth will mechanically lower the debt-to-GDP ratio in 2021 and beyond. The exceptional measures put in place in 2020 will be gradually phased out and lead to increased debt repayments. In addition, NFCs may run down the sizeable liquidity buffers they built up in 2020, as uncertainty recedes and as an alternative to new borrowing, which may also help with deleveraging.

Graph 2.3.2: **Non-financial corporations debt**



Notes: Numbers below the country abbreviations indicate the year when that debt ratio peaked, based on data between 1997 and 2020. Countries are presented in decreasing order of the NFCs debt-to-GDP ratio in 2020.
Source: Eurostat, AMECO, European Commission autumn 2021 economic forecast, and Commission services estimates for NFC debt in 2021 (see Annex 1). Debt comprises loans (F4) and debt securities (F3).

Graph 2.3.3: **Decomposition of the change in NFC debt-to-GDP in 2020 and 2021**



Notes: Net credit flows (debt transactions) correspond to transaction of loans (F4) and debt securities (F3) from the Eurostat sectoral financial transactions accounts. In 2020, the contribution of net credit flows for Luxembourg amount to 40.1 pps.
Source: AMECO, Eurostat and Commission services estimates and calculations based on ECB monthly data on MFI loans and debt securities transactions (flows) with the private sector from the BSI database, European Commission autumn 2021 economic forecast.

Overall, credit flows to NFCs since the beginning of the COVID-19 crisis have had distinctive patterns reflecting different phases of the pandemic (Graph 2.3.3 b). ([19]) Bank loans to NFCs increased in over two thirds of Member States in 2020, including in a number of Member States with high NFC debt, such as Denmark, France, Greece, Italy, Malta, the Netherlands, Portugal, Spain and Sweden. That happened against a setting where government credit guarantees helped maintain credit flows and moratoria on debt repayments kept the nominal debts higher than what they would have been. However,

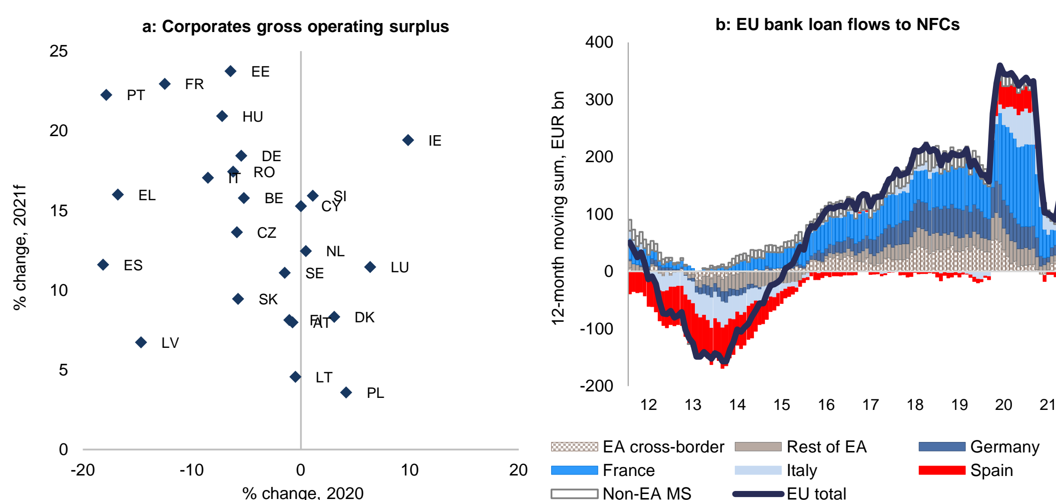
([19]) In the case of bank loans to NFCs, the onset of the pandemic in March 2020 came with a rapid acceleration of credit growth in its first months, which was particularly marked in the cases of France and Spain, among the large euro area members (Graph 2.3.4 b). This rapid rise was more muted in Germany and more gradual in Italy and less visible in non-euro area EU countries. At the same time, cross-border intra-euro area loans got more significant at the onset of the crisis. Credit growth then fell sharply, attaining rates of increase below the pre-pandemic level in most cases by early 2021. This represents a very marked departure from the gradually increasing, but broadly stable loans to corporates of recent years.

credit growth to NFCs clearly lost momentum in some large Member States more recently, attaining rates of increase below the pre-pandemic level in most cases by early 2021, in contrast to the increasing picture in the smaller Member States (Graph 2.3.4 b). To the extent that the demand for credit by NFCs is reduced due to corporations using accumulated liquidity buffers, credit flows may pick up in due course. However, the overall reduction in credit could also be a sign of muted demand for or supply of credit, which could indicate low investment activity ahead.

Credit guarantees and debt repayment moratoria helped NFCs ride out the pandemic but increased debt repayment difficulties may still emerge going forward. Credit guarantees and debt repayment moratoria were important policy measures to overcome liquidity shortages at the beginning of the COVID-19 crisis, but have also contributed to the debt increase. In some cases, non-viable and technically insolvent companies will have been able to stay in the market, defer their payment obligations, and delay liquidations that would otherwise have taken place. The delay in debt repayment by NFCs allowed by the moratoria across the EU, either as a government measure or as voluntary initiative by lenders, implied a mechanical increase in the debt stock. The phasing out of repayment moratoria over the course of 2021, may uncover debt repayment difficulties in parts of the corporate sector. The COVID-19 crisis has not resulted in an increase in corporate insolvencies so far, but these may emerge as normality returns, potentially exposing risks for the financial sector.

High corporate debt levels and low profitability in some sectors could dent investment and debt repayment prospects going forward. Profitability of corporates deteriorated in most Member States in 2020 (Graph 2.3.4 a). Although profitability of corporates rose in the first months of 2021 in nearly all Member States, vulnerabilities in service sectors more exposed to the pandemic remain. Sustained inflation dynamics could also lead to compressed profit margins and debt repayment difficulties of some firms if costs increase more than revenues, with recent developments in energy prices being a risk factor. Investment in equipment declined since the end of 2019 in all Member States but Cyprus. The decline was strong in a number of countries with large corporate debts, including Ireland, Luxembourg, the Netherlands and Belgium, as well as some countries with large tourism sectors, such as Italy, Malta, Portugal and Spain. High corporate debt levels are a risk factor for private investment going forward, particularly given the additional needs to support the green and digital transformations. As the recovery progresses, there are emergent signs that structural changes may be underway, in a context of increased supply chain disruptions. These are evidenced by the combination of tightness and slack in the labour market and persistent skill mismatches.

Graph 2.3.4: **Gross operating surplus of corporates and bank loan flows to non-financial corporates**



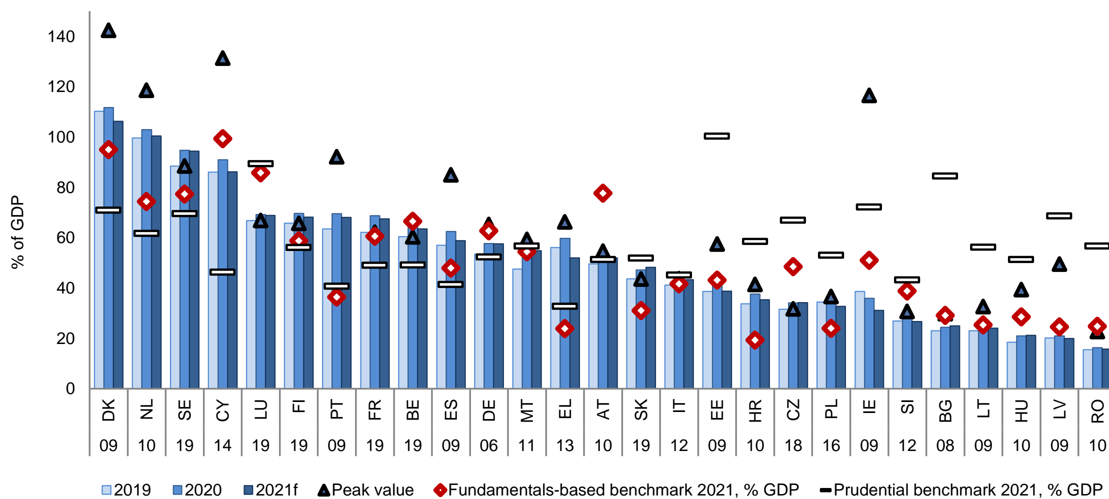
(1) Gross operation surplus to financial and non-financial corporates, national currency. Gross operating surplus not available for Bulgaria, Croatia and Malta. EU bank loan flows refer to 12-month moving sum, billions of EUR.
Source: AMECO and ECB, BSI database.

2.3.1.2. Household debt

Household debt increased with the pandemic in nearly all EU countries. Households in most EU countries were deleveraging in the run-up to the pandemic, but still displayed high levels of indebtedness (Graph 2.3.5). The pandemic interrupted household deleveraging or pushed household indebtedness further up in countries that were already on an increasing debt trajectory (Graph 2.3.6). The increase in household debt-to-GDP ratios in 2020 was, in most cases, due to the large decline in GDP (Graph 2.3.7). This impact will be at least partly reversed in 2021 as the economies start to recover. In a number of countries, dynamic credit growth, particularly mortgage debt, is likely to contribute to a more lasting increase in debt ratios in face of high real estate market activity and accelerating house prices (Graph 2.3.7 b). Overall, a number of countries, particularly those with household debt-to-GDP ratios that were above country-specific benchmarks prior to the pandemic, will continue to display high household debt.

In 2020, household debt levels in eight countries were above both what fundamentals and prudential thresholds would suggest. As in 2019, these are Denmark, Finland, France, Greece, the Netherlands, Portugal, Spain and Sweden (Graph 2.3.5). Household debt continues to exceed prudential levels in Belgium and Cyprus, despite being close to what can be explained by fundamentals, while household debt is significantly above fundamentals-based benchmarks in Croatia and Slovakia, despite being still below prudential levels. In some countries, debt ratios appear considerably higher when computed as a share of household gross disposable income. This is the case in Ireland, Luxembourg and Malta, where household debt is estimated to exceed 100% of household gross disposable income. ([20])

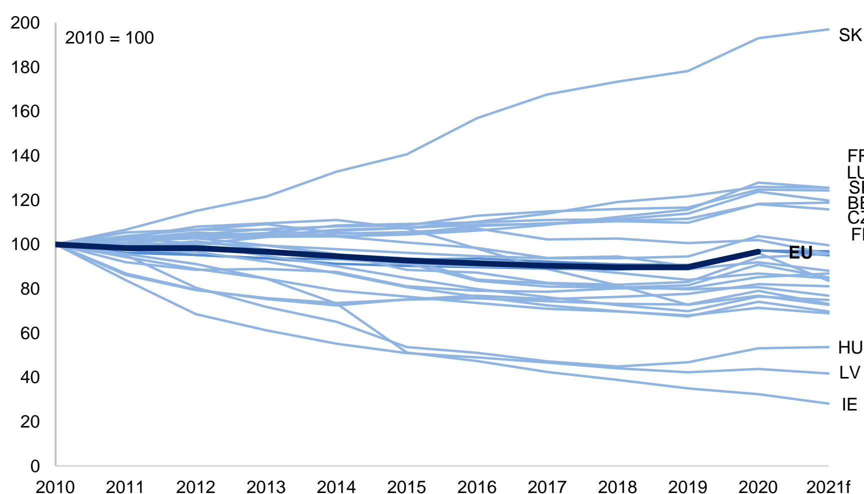
Graph 2.3.5: **Household debt**



Note: Numbers below the country abbreviations indicate the year when that debt ratio peaked, based on data between 1997 and 2020. Countries are presented in decreasing order of the household debt-to-GDP ratio in 2020.
Source: Eurostat, AMECO, European Commission autumn 2021 economic forecast, and Commission services estimates for household debt in 2021 (see Annex 1). Debt comprises loans (F4) and debt securities (F3).

([20]) For Malta this is an approximation as household GDI data is not available from the Eurostat sectoral national accounts. The estimate was obtained using the ratio of household GDI to GDP calculated from data for real GDI per capita, available in Eurostat (B6G_R_HAB).

Graph 2.3.6: **Evolution of household debt-to-GDP ratios across the EU**



Only countries with developments that deviate significantly from those of the EU as a whole have been singled out
Source: Eurostat and Commission services estimates

Household net credit flows were less affected by the pandemic than those of corporates. In 2020, debt moratoria and reduced repayments helped sustain net credit flows to households, with some variation across Member States. In Luxembourg and Sweden, countries with relatively high household debt (in Luxembourg, relative to household gross disposable income), net credit flows to households in 2020 reached around 4 to 5% of GDP. In other countries with relatively high household debt, including Belgium, Finland and France, net flows were more contained and ranged between 2% and 3% of GDP. This was also the case in Slovakia, where household debt remains below the prudential benchmark but has been increasing for a number of years above the level suggested by fundamentals, and in Malta, where household debt has also been increasing and is close to the prudential benchmark.

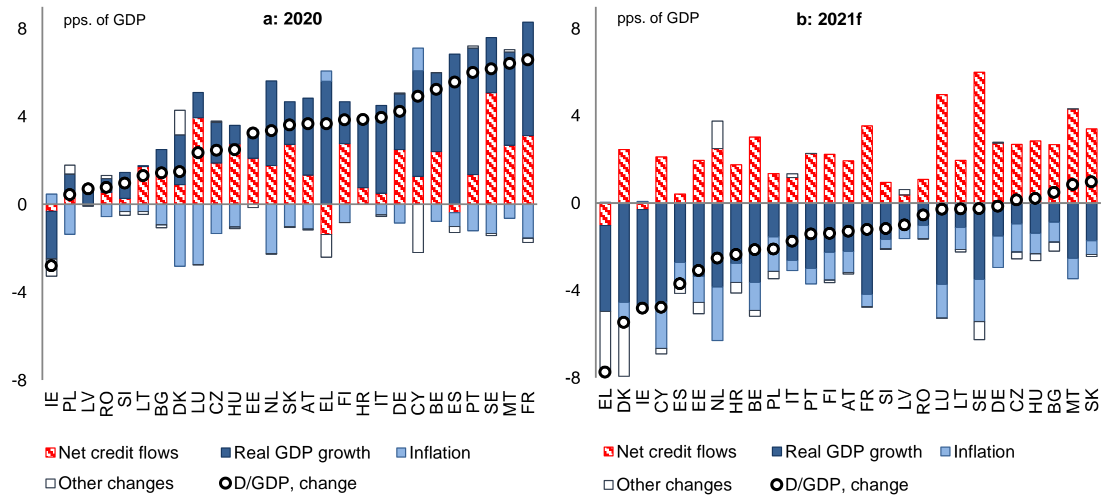
On aggregate, bank lending to households resumed its previous trend after the intense pandemic months. The pandemic marked a temporary decline in the net flow of bank loans (Graph 2.3.8 a). This was most marked in France and Spain (among the large euro area countries) and overall corresponded to a decline in the net flow of loans for consumption (Graph 2.3.8 b). Those patterns may have been linked to restrictions on mobility that hampered consumption opportunities. Conversely mortgage lending remained relatively stable before accelerating towards the end of 2020.

Household borrowing has become more dynamic in 2021. Net credit flows to households are expected to be more sizeable in a number of countries this year. Forecasts for changes in debt and net credit flows based on ECB monthly bank lending data (see Annex 1), indicate transactions picking up in most countries. The most marked increases are in Luxembourg, Malta and Sweden, with increases of over 4% of GDP, followed by Belgium, France, and Slovakia (Graph 2.3.7 b). In Finland, among the countries with higher household debt, credit flows to households are expected to remain close to 2% of GDP in 2021.

Although households have increased their savings, risks to their debt servicing capacity could still materialise. The household savings rate increased in 2020, due to forced savings in the lockdown or precautionary motives. In 2021, the aggregate household savings rate is also forecast to be above its 2019 level. Household savings rates remain relatively low in Cyprus and Greece. Denmark has also a significantly lower savings rate than other countries with high debt in terms of households gross disposable income (Graph 2.3.9 a). Over 2020 and early 2021, households accumulated financial assets, particularly deposits, leading to strengthened financial positions. Debt repayment risks related to an increase in unemployment that would negatively affect household income remain limited (Graph 2.3.9 b). However, although households currently face very low interest burdens, a change in the stance of

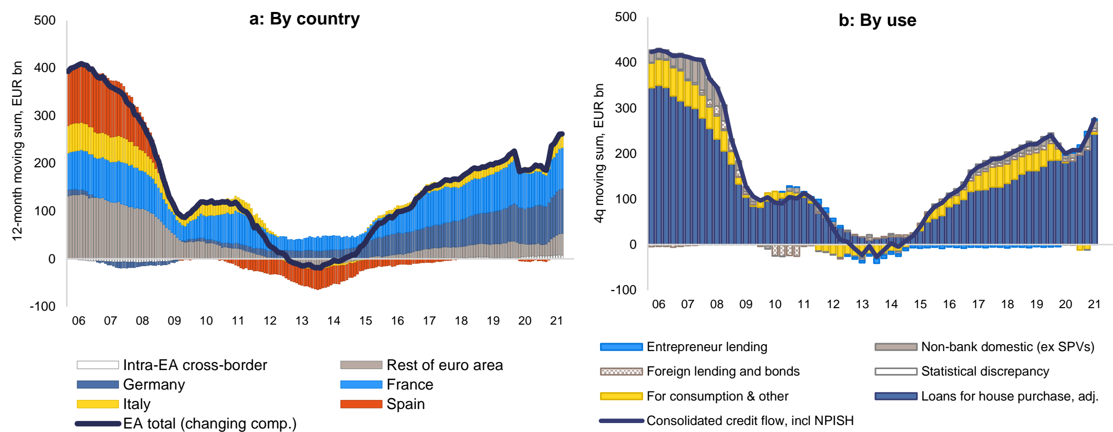
monetary policy may affect their debt servicing capacity, particularly where variable rate contracts predominate. ([21])

Graph 2.3.7: **Decomposition of the change in household debt-to-GDP in 2020 and 2021**



Source: Eurostat. Net credit flows (debt transactions) correspond to transaction of loans (F4) and debt securities (F3) from the Eurostat sectoral financial transactions accounts. Other sources are AMECO and Commission services estimates and calculations based on ECB monthly data on MFI loans and debt securities transactions (flows) with the private sector from the BSI database.

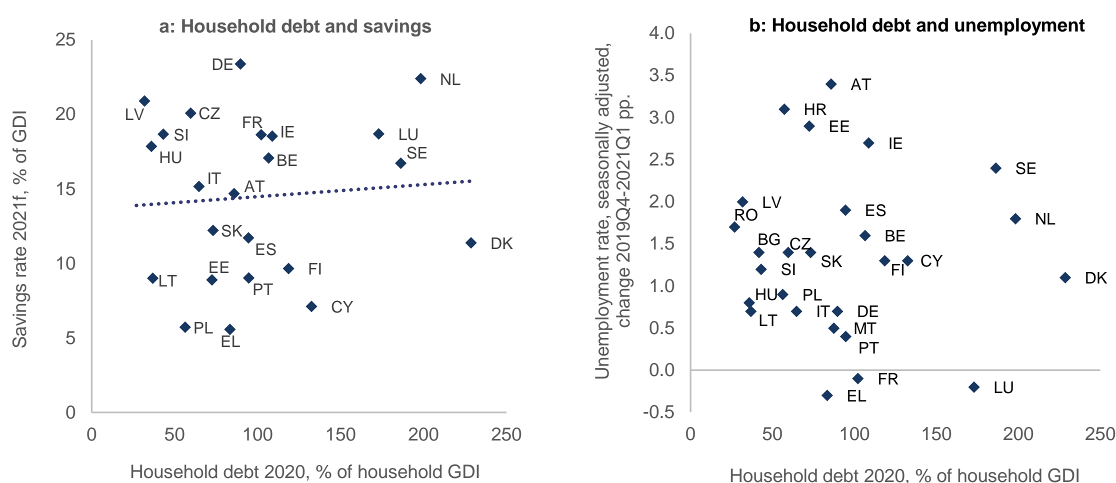
Graph 2.3.8: **Euro area bank loan flow to households**



Note: Graph a: 12-month moving sum and Graph b: 4-quarter moving sum
Source: ECB

([21]) The share of variable rate contracts for new housing loans has been above or close to 90%, since 2013 at least, in Bulgaria, Cyprus, Finland and Latvia.

Graph 2.3.9: **Household debt, household savings and unemployment risks**



Source: Eurostat and AMECO. For Malta GDI is obtained using the ratio of household GDI to GDP calculated from data for real GDI per capita, available in Eurostat (B6G_R_HAB). For Bulgaria and Croatia household GDI was also calculated using 2020 GDP and the last available ratio household-GDI-to-GDP, as GDI data for 2020 is not available also for these countries.

2.3.2. HOUSING

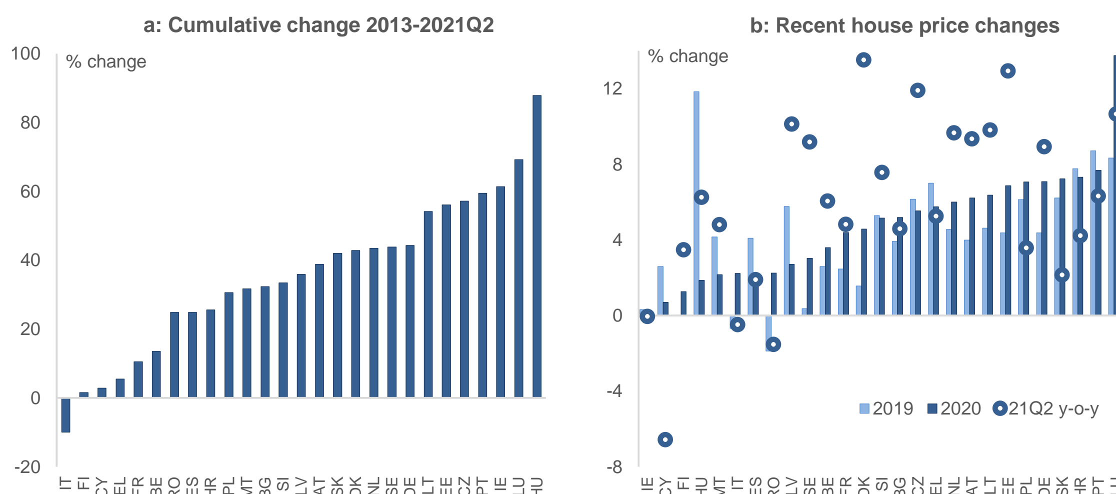
In 2020, ten Member States experienced real house price increases above the scoreboard threshold of 6%. These are Austria, Croatia, Estonia, Germany, Lithuania, Luxembourg, the Netherlands, Poland, Portugal and Slovakia (Graph 2.3.10 b), two countries more than one year ago. In the cases of Croatia, Luxembourg, Poland and Slovakia, this is the second consecutive year with house price increases above this threshold, while Portugal has had increases above 6% in every year since 2016.

In 2021, house prices have continued growing strongly in most Member States. Real house prices have further accelerated in the first half of this year, with 14 EU countries displaying year-on-year real house price increases beyond 6% (Graph 2.3.10 b). In Czechia, Denmark, Estonia, Latvia and Luxembourg year-on-year real growth exceeded 10%. Over the first two quarters of 2021, real house prices decreased in Cyprus, and to a lesser extent, Romania, and were essentially constant in the cases of Ireland and Italy.

The growth of house prices has been driven by a variety of factors fuelling demand and constraining supply. Supply constraints were present before the pandemic and while lockdowns exacerbated them temporarily, they can be expected to persist over coming years. The pandemic may have led to some structural changes in housing demand as a shift to remote working may change geographical preferences. In some locations this could mean demand outpacing supply. Financial conditions have been accommodative and overall are likely to continue supporting elevated housing demand. With household incomes growing with the recovery, further house price growth appears likely.

The recent house price increases reinforce the steady upward trend in house prices that has taken place since 2013 across the EU. Real house prices have increased in all Member States with the exception of Italy. The largest increases, by decreasing order, have been observed in Hungary, Luxembourg, Ireland, Portugal, Czechia, Estonia and Lithuania (Graph 2.3.10 a). In 2020, the only EU country that did not see a continuation of this increasing trend was Ireland, which displayed broadly stable prices in 2019 and 2020.

Graph 2.3.10: **Real house price changes**



Note: Data for Greece refers to 2021Q1 instead of 2021Q2
Source: Eurostat and Commission services calculations

House prices appear to be overvalued in most EU countries. A comparison of house prices indexes with benchmarks that consider the impact of fundamental drivers of prices such as income and demographics shows widespread evidence of overvaluation. ([22]) This is particularly the case for Austria, Belgium, Czechia, Denmark, France, Germany, Hungary, Luxembourg, the Netherlands, Portugal, Slovakia and Sweden, which all feature sizeable gaps (Graph 2.3.11 a). Measures of affordability – based on the number of years of average income needed to buy a 100 square metre home ([23]) – show strong overvaluation in Malta, Ireland and Croatia, while more than ten years of income are needed to buy a 100sqm home in eleven other Member States. These are Austria, Cyprus, Estonia, France, Greece, Hungary, the Netherlands, Poland, Portugal, Spain and Sweden (Graph 2.3.11 b).

In a number of cases, indications of potential house price overvaluation combine with high household debt or accelerating mortgage credit. Luxembourg combines high and strongly growing house prices with very high levels of household debt. Austria, Belgium, Denmark, France, Germany, the Netherlands, Portugal and Sweden, display signs of potentially overvalued house prices with substantial – in the case of Denmark very high – household debt. In the case of Slovakia, indications of potentially overvalued house prices occur alongside the largest increase in household debt in recent years, although starting from a low level.

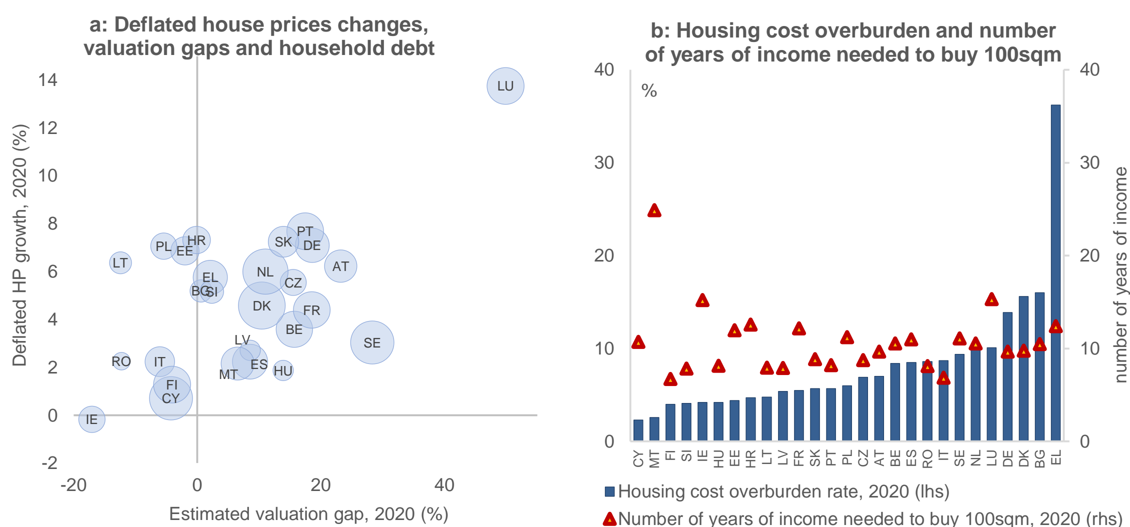
Risks of substantial downward adjustments of house prices are mitigated by the presence of supply-side constraints, but economic concerns remain. Macroprudential measures have been put in place in many Member States and have contributed to reduce the risks for the overall financial stability related to the housing market. ([24]) Less dynamic housing supply contributed to the prices rises; however, lower construction also reduces the direct economic impact of a correction in house prices.

([22]) House price valuation gaps are computed with respect to benchmarks to capture country-specific effects. Synthetic valuations gaps are based on the gap obtained from different benchmarks: (i) price-to-income deviation with respect to its long-term average; (ii) price-to-rent deviation from its long-term average; (iii) deviation from regressions-based benchmarks taking into account demand and supply economic fundamentals (see N. Philiponnet and A. Turrini (2017), "Assessing House Price Developments in the EU", European Commission Discussion Paper 048, May 2017). In the computation of the regression-based benchmarks, cyclical explanatory variables are HP filtered to contain their volatility.

([23]) Price level estimates are obtained on the basis of national account and census data or, when not available, information published on real estate agents websites. See J. C. Bricongne et al. (2019)," Assessing House Prices: Insights from "Houselev", a Dataset of Price Level Estimates", European Economy, Discussion Paper No. 101, July 2019.

([24]) Macroprudential measures are monitored by the European Systemic Risk Board (ESRB). In September 2019, the ESRB issued country-specific warnings and recommendations on medium-term vulnerabilities in the residential real estate sector to nine Member States: recommendations to Belgium, Denmark, Finland, Luxembourg, the Netherlands, and Sweden, and warnings to Czechia, France, and Germany. Of the former group of countries, all had already received warnings by the ESRB in November 2016, and the same held for Austria. The MIP Regulation (Regulation (EU) No 1176/2011) calls on the Commission to take

Graph 2.3.11: **House prices, valuation metrics, household debt and housing cost overburden**



Notes: The size of the bubbles in the left panel chart corresponds to household debt in % of GDP in 2020. See footnote 22 for information on the valuation gaps. The housing cost overburden rate is the percentage of the population living in households where the total housing costs ('net' of housing allowances) represent more than 40 % of disposable income ('net' of housing allowances).
Source: Eurostat and Commission services calculations

Housing affordability has deteriorated. As house prices have been growing faster than household incomes, housing affordability has deteriorated. The increases in house prices are not reflected in an acceleration of household indebtedness, overall, but this could materialise in the future as house purchases become more expensive. House price growth has outpaced income growth in all EU countries except Latvia, Cyprus and Ireland in 2020. In Luxembourg, Germany, Denmark and Bulgaria, more than 10% of population spend at least 40% of their disposable income on housing costs; in Greece this is the case for more than 36% of the population (Graph 2.3.11 b). Apart from the obvious social effects, this can also have significant macroeconomic implications, principally through a misallocation of resources. High house prices may lead to a reduction in aggregate private consumption and increase the net external trade balance if house buyers have a higher-than-average propensity to consume. When accompanied with borrowing, it can lead to a diversion of credit from productivity-enhancing investments. Last but not least, a lack of affordable housing can negatively impact labour mobility and, by extension, competitiveness.

The commercial real estate (CRE) market was significantly affected by the COVID-19 shock amid a large drop in transactions and price corrections. CRE has decoupled from residential real estate developments since the COVID-19 outbreak. CRE transactions fell significantly, and its retail segment suffered a major price correction. While incompleteness of data on CRE does not allow a robust assessment of risks and vulnerabilities, investor surveys suggest that market sentiment is still deteriorating. ([25]) This may represent a risk for some banks as CRE is commonly used as collateral for NFC loans but especially for real estate funds that are the main direct CRE holders.

into account any warnings or recommendations addressed by the ESRB to Member States subject to an IDR. An updated of the 2019 report is expected in the beginning of 2022.

([25]) ECB (2021): Financial Stability Review, May 2021 on the basis of RICS Global Commercial Property Monitor.

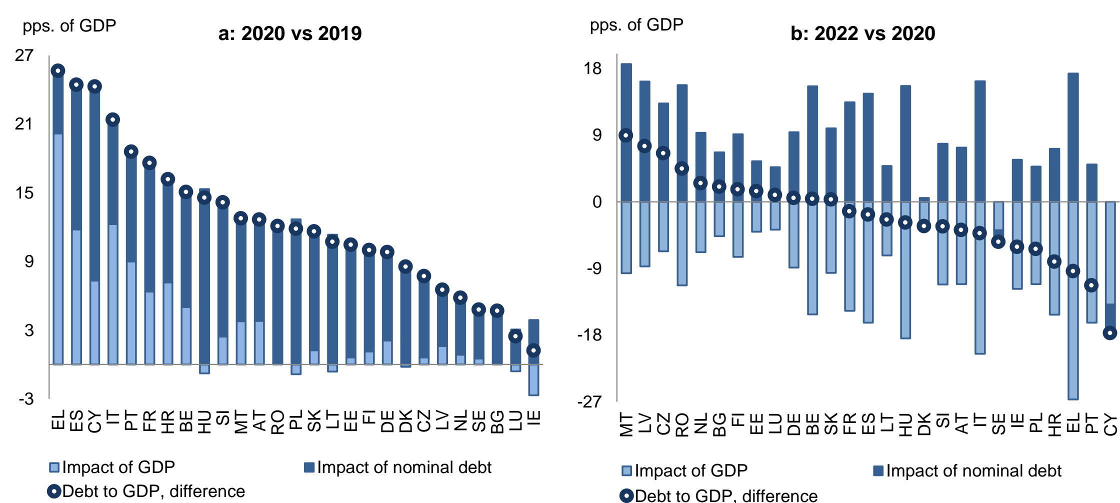
2.4. GOVERNMENT SECTOR

The COVID-19 crisis and the measures governments took to cushion it have had a major impact on government debt, which increased in all Member States in 2020. In 2020, government debt exceeded the scoreboard threshold (of 60% of GDP) in the case of 13 Member States (Austria, Belgium, Croatia, Cyprus, Finland, France, Germany, Greece, Hungary, Italy, Portugal, Slovenia and Spain), which is two more than in 2019 when Finland and Germany were below the threshold. While the – mostly temporary – measures introduced in 2020 had an immediate upward impact on the debt, by adding to its nominal value, they reduced the impact of the pandemic-induced recession on other sectors of the economy.

The increases in government debt in 2020 have been most pronounced in countries hit hard by the COVID-19 shock. The increase in 2020 was over 20 percentage points of GDP in case of Cyprus, Greece, Italy and Spain. By 2022, the largest increases in GDP relative to their 2019 levels are forecast to have occurred in Belgium, Greece, Spain, France, Italy, and Malta. Of these, Belgium, France, Greece, Italy and Spain entered the pandemic with high debt levels, which are forecast to stabilise by 2022.

The increase in debt-to-GDP ratio between 2019 and 2020 was a result of an increase in nominal debt and an abrupt fall of GDP. In most countries, the largest contribution came from the increase in nominal debt, which includes the impact of the policy measures introduced to support the other sectors of the economy. In the case of Greece and Italy, however, over half of the increase in the debt ratio came from the denominator effect, which is more considerable for higher starting debt levels and where the recession was stronger (Graph 2.4.1).

Graph 2.4.1: **Decomposition of changes in government debt-to-GDP ratios**



Source: AMECO, European Commission autumn 2021 economic forecast

The outlook for 2021 and 2022 foresees a general stabilisation of government debt, although in some cases it is set to rise further. By end 2022, around half of the Member States are expected to have government debt-to-GDP above their 2020 levels (Graph 2.4.1 b). In several countries, government debt is forecast to further increase in 2021, on the back of still considerable government deficits (Graphs 2.4.2 and 2.4.3 b), with Malta and Slovakia expected to go over 60% of GDP. In 2022, the debt-to-GDP should be on a downward path in most countries, although it is projected under a no-policy change scenario be increasing in Belgium, Czechia, Estonia, Latvia, Malta and Romania.

Government financing conditions have been benign. Government bond yields remained stable or even presented a slightly decreasing trend in 2020 right after a moderate spike at the outbreak of the pandemic. They increased slightly in 2021 while showing a convergence path, especially among the euro area countries. Government bond yields in Poland, Czechia and Hungary have increased somewhat while in the case of Romania increases have been more pronounced. The reduced volatility resulted from policy actions that supported government financing. The monetary policy carried out by the ECB and other

central banks in the EU was critical in that respect and the supportive fiscal stance and monetary policy measures have been mutually reinforcing in maintaining confidence and stability.

Gross financing needs increased significantly in 2020 but are expected to decrease steadily in the coming years. The pandemic outbreak resulted in a noticeable rise of gross financing needs in all Member States, in many cases by more than 10 percent of GDP (Austria, Cyprus, Finland, France, Italy, Malta, Poland, Slovakia, Slovenia and Spain). The highest gross financing needs in 2020, around 30% of GDP, were reported in Italy and Spain (Graph 2.4.3 a). Financing needs are forecast to start falling in 2021 or 2022 in the case of most Member States, which is aligned with the deficit decreases over the next years (Graph 2.4.3 b). Nevertheless, in 2022, gross financing needs are forecast to be above 20% of GDP in France, Italy and Spain.

The structure of government debt might compound risks in some cases, including Bulgaria ([26]), Croatia, Hungary and Romania for which the share of debt denominated in foreign currencies is the highest. ([27]) Notably the relevance of debt in foreign currency for countries outside the euro area and higher re-financing needs associated to structures tilted to low average maturity stand out in this respect. Less developed and liquid markets at home might also raise financing risks in some cases.

There are also some mitigating factors to the higher fiscal sustainability risks relative to before the pandemic. Over the next decade, debt is forecast to remain above pre-pandemic levels in about one third of Member States. ([28]) However, the favourable differentials between interest rate and GDP growth in the coming years are expected to help stabilising or reducing the debt ratios. The fiscal risks might also be mitigated thanks to longer debt maturities, relatively stable financing sources and historically low borrowing costs. Simultaneously, the effective implementation of reforms and investment under the Recovery and Resilience Facility should support potential growth and improve debt sustainability.

The potential risks stem from an increase in interest rates or a materialisation of the COVID-19 related guarantees. Increases in interest rates could lead to increases in interest payments, particularly for countries with high financing needs in the future. The stock of guarantees could also yield additional fiscal costs: it increased in the euro area by 14 percentage points of GDP between 2019 and 2020. Governments with less fiscal space (including Belgium, France, Italy, Portugal and Spain) implemented more generous guarantee schemes. While these enabled support to be granted without directly affecting fiscal balances, they will add to government debt if they are called. ([29])

Going forward, managing the appropriate path to restore fiscal sustainability will be important for the recovery. The general escape clause of the Stability and Growth Pact, which allowed the Member States to support their economies in the midst of the COVID-19 crisis is expected to be deactivated as of 2023. When economic conditions allow, achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term will be essential. The risks related to large public debt should be balanced with the risks stemming from premature withdrawal of COVID-19 fiscal measures as it may slow the recovery ([30]) and have a negative impact on growth over time. For countries like Belgium, Cyprus, France, Portugal and Spain that have high levels of both public and private debt, the implications for the growth developments may be even more pronounced.

([26]) In Bulgaria the risk coming from the currency composition of external debt is mitigated due to the currency board regime. In addition, in the case of Bulgaria and Croatia, the accession to ERM II may also smoothen the debt sustainability risks thanks to lower risk premia.

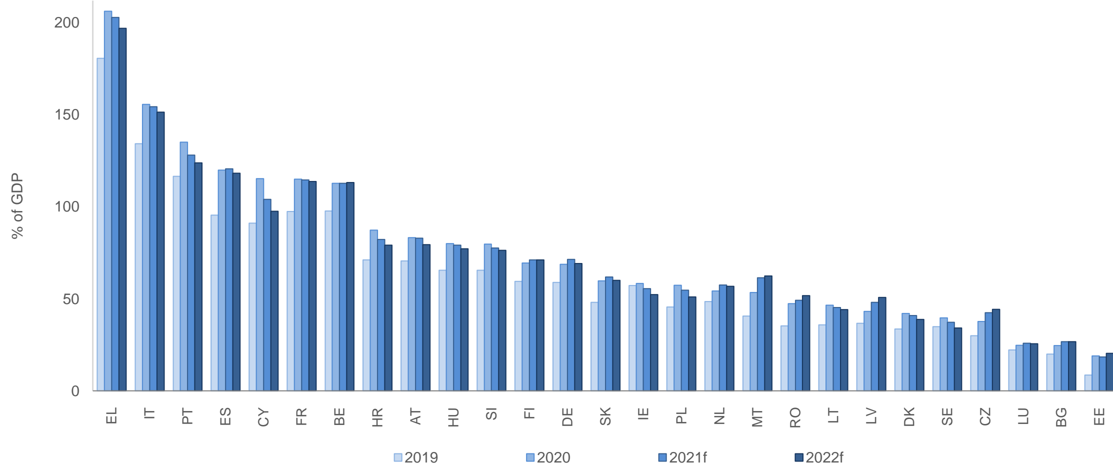
([27]) In July 2021, the share of government debt denominated in foreign currency was: Bulgaria 82%, Croatia 72.1%, Romania 51.1%, Poland 22.9%, Hungary 21.7%, Sweden 20%, Denmark 10.1%, Czechia 8%.

([28]) European Commission (2021), The 2021 Stability and Convergence Programmes: an Overview, with an Assessment of the Euro Area Fiscal Stance.

([29]) ECB (2021), Financial Stability Review

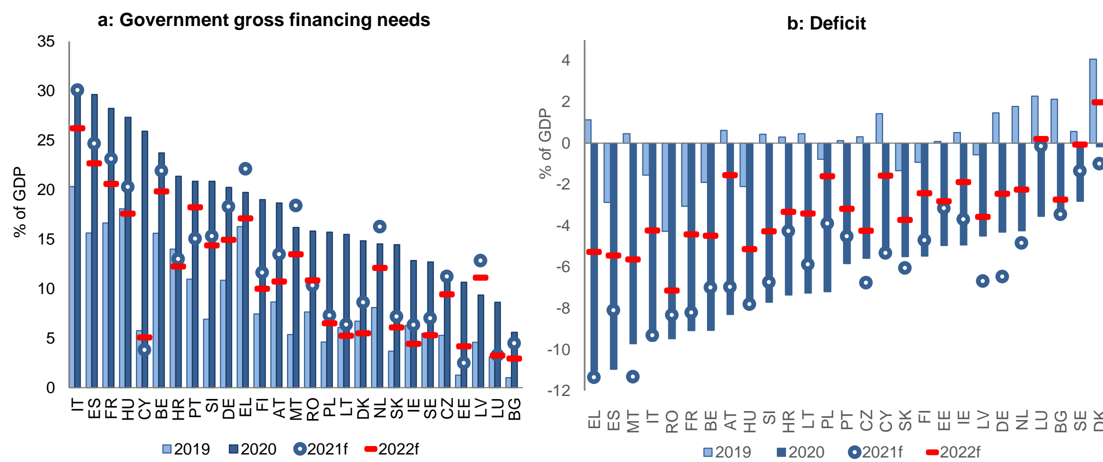
([30]) IMF (2021), Fiscal Monitor April 2021

Graph 2.4.2: **Government debt**



Source: AMECO and European Commission autumn 2021 economic forecast

Graph 2.4.3: **Government gross financing needs and deficit**



Source: AMECO, European Commission autumn 2021 economic forecast and Commission services calculations

2.5. FINANCIAL SECTOR

The EU banking sector has shown resilience in the face of the pandemic so far, although it remains marked by pre-existing challenges, such as low profitability. The EU banking sector entered the pandemic well capitalised after several years of strengthening following the heavy fallouts of the global financial crisis and the sovereign debt crisis. However, the robustness of the sector has varied across countries, with some still marked by sizeable non-performing loans, and with low profitability being a widespread concern.

- **The EU banking sector has remained resilient, both due to its strong starting position and the policy measures introduced during the pandemic.** Overall, strong capital buffers were built in pre-pandemic years, and the common equity tier 1 (CET1) and solvency ratio further increased in 2020, assisted by regulatory limits on dividends. Non-performing loans (NPLs) continued decreasing amid the disposal of legacy assets, and new NPLs were muted by moratoria on loan repayments introduced after the pandemic breakout. The new credit was, in turn, supported by government guarantees for corporate loans and temporary macro-prudential easing and financial conditions have remained loose in 2021. The growth in financial sector liabilities remained limited in 2020, with only Estonia, Greece, Hungary and Lithuania going beyond the scoreboard threshold. Recent stress tests by the European Banking Authority (EBA) show that, overall, the EU banking sector is resilient but there are large differences across banks and those focused on domestic lending or with lower net interest income would face higher capital depletion. ([31])

- **A main challenge of EU banking sector remains its low profitability** (Graph 2.5.1 a). The return on equity, which has been persistently low in most Member States, dropped further in 2020 in view of higher loan loss provisions and lower revenues. Profitability turned negative in Cyprus, Greece, Ireland, Portugal and Spain. In 2021, there are signs of recovering profitability. ([32]) These cautiously positive developments are also reflected in the market valuation of the EU banks. These have gradually recovered to pre-pandemic levels since last autumn, but remain somewhat below the overall stock markets.

- **The banking sector in some EU countries remains challenged by combinations of very low profitability, below average capital ratios or elevated NPLs** (Graph 2.5.1). ([33]) In Greece, the NPL ratio has declined significantly but it is still elevated, ([34]) while profitability turned negative in 2020 and capital ratios rank among the lowest in the EU. Cypriot banks have also recorded considerable reductions in their very high NPL ratios, while profitability also turned negative in 2020. In several other countries, NPL ratios have declined markedly over the last years, but they close to 5% in Bulgaria, Croatia and Poland. The capital ratio is well below average in Spain and Portugal, and profitability also turned slightly negative there in 2020.

([31]) In July 2021, the European Banking Authority (EBA) published results of the EU-wide stress test involving 50 banks from 15 EU and EEA countries, which cover 70% of the EU banking sector assets. This exercise had a specific focus on loans under moratoria and with public guarantees. This year's stress test considered a prolonged COVID-19 scenario in a "lower for longer" interest rate environment, which assumed an EU GDP decline of 3.6% over three years. The results suggest that the EU banking sector would stay above a CET1 ratio of 10%, with a capital depletion of EUR 265bn against a starting CET1 ratio of 15%. Credit losses would explain most of the capital depletion. The scenario would also result in a significant decrease in the contribution of profits from continuing operations, especially from net interest income.

([32]) The median return on equity of EU banks fell from 5.8% in 2019 to 2.7% in 2020. However, it increased to 7.1% in Q2 2021.

([33]) NPLs in the set of scoreboard auxiliary indicators is defined as total gross NPLs and advances as percentage of total gross loans and advances (gross carrying amount), for the reporting sector "domestic banking groups and stand-alone banks, foreign controlled subsidiaries and foreign controlled branches, all institutions". Harmonised data on NPL ratios are available only since 2014. Thus, for the data concerning the "peak", Graph 2.5.1 b displays data for the ratio of gross non-performing debt instruments (NPDs) over total gross debt instruments, which is available in longer time series, and that refers, besides loans, also to other debt instruments held by the banking sector. The latter is typically slightly lower than NPL ratios, much because the denominator is larger, i.e., total gross debt instruments are larger than total loans. The difference between the two ratios currently amounts to 5 percentage points for Greece and 2 p.p. for Cyprus, while for most countries it is below 1 p.p.

([34]) Graph 2.5.1 b is based on Q1 2021 data when NPL ratio for Greece was 26%. The data for Q2 2021 released after the cut-off date of the AMR (22 October 2021) point to very substantial reduction of the NPL ratio towards 16% (provisional value).

Risks to the banking sector remain and the full impact of the crisis on asset quality, profitability and capital buffers will only be visible once the support measures are fully withdrawn. The impact of the COVID-19 shock on the banking sector has been limited by extensive support policy measures, aimed mostly at the corporate sector. These are being gradually withdrawn and most measures are scheduled to expire by the end of 2021. Their withdrawal will expose underlying solvency or liquidity issues. This represents a risk for the banking sector as debtors will need to meet repayment obligations that they had been shielded from.

- **Corporate and household solvency difficulties may still materialise as normality is restored.** Private debt was already high in several Member States before the pandemic and increased further in 2020. Corporate solvency issues represent a major risk, particularly in some sectors more affected by the crisis. So far, corporate insolvencies have remained low. Risks related to household mortgage debt have so far been contained by public income support schemes and increased household savings. Long-standing supply issues in housing markets reduce the risk of material downward adjustments in house prices. Nevertheless, future solvency issues in the corporate sector could lead to a knock-on effect on employment, and affect household solvency as well.

- **NPLs are expected to rise, especially in some sectors and countries.** Difficulties in debt repayment by NFCs whose profitability is most affected could lead to an increase of NPLs. Already there has been a marked increase in Stage 2 loans, which represent loans with significantly increased credit risk. ([35]) The share of Stage 2 loans in the euro area was 13% in 2020 and is expected to increase to 17% in 2021. ([36]) The regional distribution of economic activities means that increases in NPLs may be unevenly distributed across regions, and therefore disproportionately affect certain countries banking sectors. ([37]) The increase of interest rates can represent another challenge for highly leveraged firms with low liquidity buffers.

- **Feedback loops between banks, sovereigns and NFCs should be closely monitored**. In the euro area, the ECB's pandemic emergency support programme underpinned benign financial market sentiment and contributed to stability of the banking sector during the pandemic. However, banks in some countries absorbed a large share of the newly issued public debt, which was partly driven by support measures towards corporate sectors. This represents a risk in view of the interconnectedness between bank balance sheets, the corporate sector and the level of public debt, not least in a situation of potential increases of long-term rates globally.

Structural challenges for the banking sector that were present before the pandemic remain, and may be more difficult to resolve. Excess capacity has been a long-term challenge of EU banking sector, resulting in low cost efficiency and low profitability. The ongoing process of digitalisation and green transition pose new challenges for the banking sector that will have to redirect funding across industries at times when its persistently low profitability constrains its own investment, and which could be exacerbated if its asset quality was to deteriorate.

The non-banking financial sector, which has been affected by the persistent low interest rate environment, is facing new challenges. The persistent low-yield environment strained the profitability and balance sheet of non-bank financial institutions with asset portfolios largely invested in low-risk assets such as insurers and pushed them to increase their leverage and exposure to more risky assets. ([38]) An abrupt increase of the interest rates outlook could trigger a global repricing of risks implying asset valuation losses for the EU non-banking sector. Life insurers seem to be most affected so far by the

([35]) Stage 2 loans are loans whose credit risk has significant increased since its initial recognition but unlike in case of Stage 3 loans are not yet considered credit-impaired or in default.

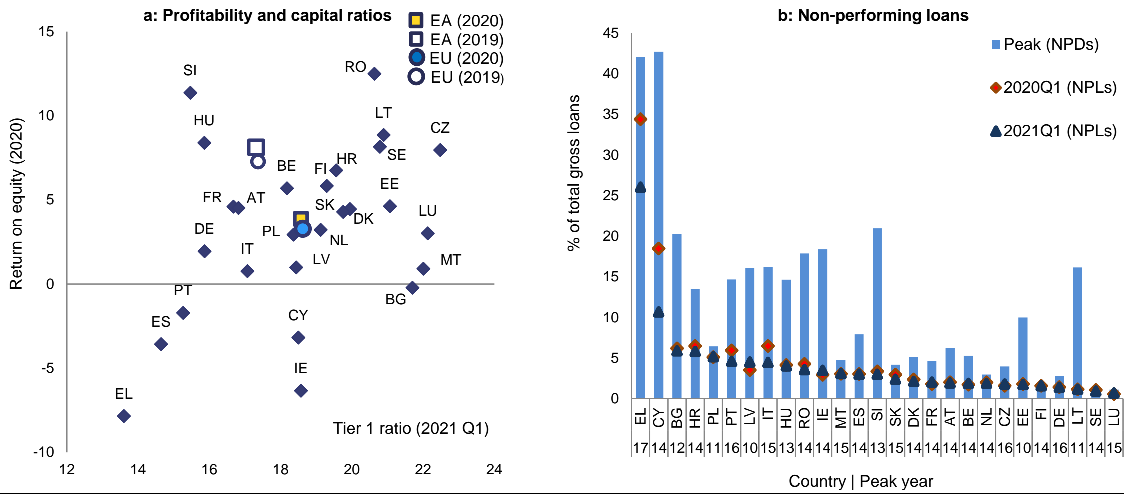
([36]) ECB (2021), Financial Stability Review, May 2021.

([37]) The euro area data confirm that Stage 2 loans increase was more pronounced for sectors more affected by the pandemic and the restrictions on mobility, e.g. in accommodation services from 7% in 2019 to 25% in 2020 and in the area of arts and entertainment from 6% to 23% respectively. ECB (2021): Financial Stability Review, May 2021. Similar trends are also visible in recent NPL data. EBA Risk Dashboard for Q2 2021 shows that diverge in asset quality across sectors increase. For example, for accommodation and food service the NPL ratio rose further from 9% in Q1 2021 to 9.6% in Q2 2021 and for arts, entertainment and recreation from 7.9% to 8.2%.

([38]) ECB (2021), Financial Stability Review, May 2021.

COVID-19 shock as their premiums declined in 2020, while they increased for the non-life business. ([39]) Furthermore, the pandemic led to some commercial real estate price corrections that had an effect on the performance of real estate funds (see section on housing above).

Graph 2.5.1: **Banking sector profitability and capital and non-performing loans**



Notes: The average values for the EU and the euro area are unweighted by the economy size. Data concerning the "peak" refer to the ratio of gross non-performing debt instruments (NPDs) over total gross debt instruments; NPL ratios are reported for 2020Q1 and 2021Q1; numbers below the country codes indicate the year when NPDs peaked.
Source: ECB, Commission services calculations.

([39]) EIOPA (2021), Financial Stability Report, July 2021.

Box 2: **Employment and social developments**

Throughout the pandemic the labour market remained resilient, largely thanks to unprecedented support measures at national and EU level. The widespread use of job retention schemes, supported by the EU instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) and other types of interventions, including extensive fiscal and monetary support, cushioned the impact of the COVID-19 shock on jobs and incomes, and prevented the health crisis from becoming a job crisis. The effect of the COVID-19 recession on labour markets was generally V-shaped: in most countries, labour markets were significantly affected at the very onset of the crisis, but a partial rebound rapidly followed, largely owing to the brisk recovery in economic activity. ([1])

Unemployment increased only slightly in 2020 compared to the size of the shock and is expected to fall back to around pre-pandemic levels in 2022. The EU unemployment rate (15-74 years old) rose to 7% in 2020 (with a peak of 7.7% reached following the first wave of the pandemic), only 0.3 percentage point (pp) above the average 2019 level. Such increases were low compared to the GDP contraction of around 6% for the EU as a whole. ([2]) The highest increases were recorded in the Baltics (2.4 pp in Estonia, 2.2 pp in Lithuania and 1.8 pp in Latvia), Sweden (1.5 pp) and Spain (1.4 pp). In seventeen EU countries, the unemployment rate moved up by less than one percentage point. The unemployment rate even fell in Poland, France, Italy and Greece in 2020. In the first half of 2021, unemployment decreased in a majority of Member States. The youth unemployment rate (15-24) in the EU showed initial signs of recovery by mid-2021 but still stood at 17.4% in the second quarter of 2021, nearly triple the unemployment rate of the population aged 25-74 years old. According to the Commission's autumn 2021 economic forecast, the EU unemployment rate is still expected to stabilise in 2021 but then to fall back to around pre-pandemic levels in 2022.

However, the lower-than-expected increase in unemployment rates partly reflects withdrawals from the labour market and thereby lower activity rates. The activity rate (15-64 years old) dropped by 1.7 pp – from 73.6% in the fourth quarter of 2019 to 71.9% in the second quarter of 2020 – but returned to its pre-pandemic level in the second quarter of 2021. The activity rates fell in most Member States in 2020, with the highest declines (between 1 pp and 2 pp) recorded by Italy, Spain, Ireland, Portugal, Bulgaria and Greece. In 2021, it has remained below pre-pandemic levels in a significant number of cases.

Employment rates, while falling in almost all Member States in 2020, are gradually rebounding in 2021, but not in all sectors. In the EU the employment rate (20-64 years old) fell to 72.4% in 2020 from 73.1% in 2019. The largest falls were observed in Spain (-2.3 pp), Ireland (-1.7 pp), and Bulgaria (-1.6 pp), while Poland (+0.6 pp), Malta (+0.5 pp) and Croatia (+0.2 pp) were the only countries in which the employment rate increased. In the first quarter of 2021 employment rates still fell in most Member States, but in the second quarter of 2021 they increased again, gradually returning to pre-pandemic levels except notably in sectors most hit by social distancing needs.

Government support measures have mitigated the effect of the fall of market incomes on disposable incomes. In addition to the use of job retention schemes, governments implemented a range of measures to raise net transfers, including extended unemployment benefits or the deferrals of certain payments such as tax or utility bills on the top of moratoria on debt repayments. The real gross disposable household income per capita fell by 2.7% (year-on-year) in the second quarter of 2020, but recovered by the end of the year and remained largely unchanged between 2019 and 2020. The increase in the at risk of poverty or social exclusion rate (AROPE) in 2020 was contained or decreased compared to 2019 in at least half of the Member States. Increases were, nonetheless, estimated for some Member States. ([3])

Nevertheless, important challenges lie ahead.

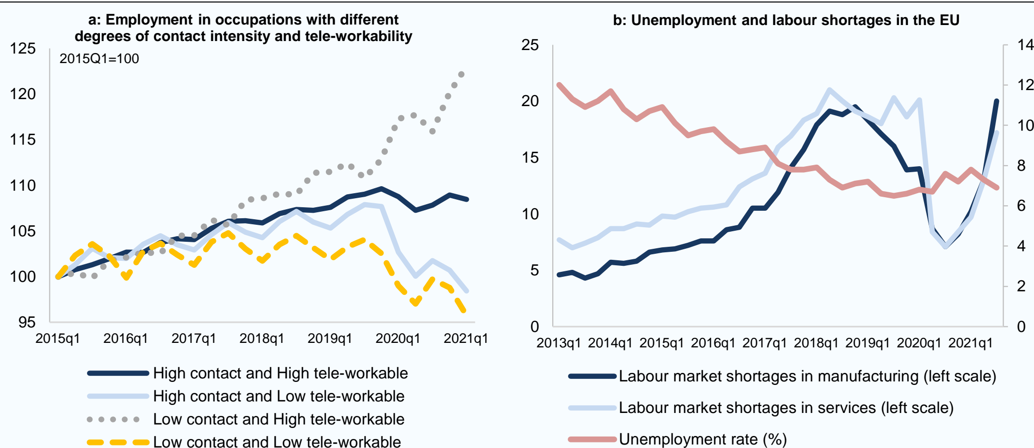
The pandemic has accelerated structural trends in the labour market, raising concerns for the people affected. The long-term trend of falling labour demand for occupations with routine tasks has accelerated (Graph 1 a). Low tele-workable occupations can be increasingly affected by

automation. In addition, the phasing-out of support measures might lead to significant job shedding in the most supported sectors depending on the extent to which the demand for the related goods and services will recover. The speed and effectiveness of labour reallocation will depend on whether the skills of displaced workers are sector-specific or adaptable to other sectors, and effectiveness of re-skilling and up-skilling. While such reallocation could accompany the twin transitions and lead to productivity and competitiveness gains, the duration of unemployment may increase in the absence of targeted and effective policy interventions. In their national recovery and resilience plans, most Member States plan measures to support job recovery, but a strengthened coordination of the measures will be key for successful labour market transitions. ([4])

Labour shortages are re-emerging, raising need for re-skilling and up-skilling (Graph 1 b). Prior to the pandemic, labour shortages were already at a historical peak across the EU. Containment measures linked to the pandemic and the resulting economic disruptions drove the decline in labour shortages as many firms withdrew their job openings during the lockdown. However, labour shortages are on the rise again in most countries with sizeable increases in job vacancies in Austria, Belgium, Croatia, Germany, Lithuania, Portugal, Slovakia and Slovenia. Shortages currently affect in particular the information and communication sectors and construction. The growing labour shortages may not only reflect the quick recovery from the deep recession and a decrease in the number of cross-border workers, but also signal that skills mismatches, which had already existed before the crisis, may grow further with the progress of the twin transitions. ([5])

The pandemic and its aftermath risk increasing inequality in various forms. In 2021, long-term unemployment has increased in most Member States, as more people have been unemployed since the pandemic started. The large interruption in recruitment limited opportunities for unemployed and labour market entrants, including many young people or migrants. ([6]) Youth unemployment rose significantly during the pandemic in most Member States and in the second quarter of 2021 it stood above 30% in Greece (38.5%), Spain (38.2%) and Italy (32.2%). Lockdowns also exacerbated inequalities in access to education to health and social services and that may have an impact on the labour market in the medium and long term, while the impact on working hours was stronger for workers with lower education levels. In addition, with the exception of the Netherlands, workers on temporary contracts were particularly affected by job losses in 2020. While income support measures have strongly mitigated the regressive impact of the crisis on labour market incomes ([7]), there remain major concerns for the labour market prospects of these workers, also given the decreasing relative demand for non-teleworkable and routine occupations.

Graph 1: **Employment and unemployment evolution**



Notes: (a) This Graph uses an index of technical teleworkability and physical proximity. It relies on the O*NET survey that measures the task content of specific occupations. This information is matched with the EU-LFS; (b) The European Business and Consumer Surveys (EU-BCS) collects quarterly data from employers on their difficulties to fill vacancies. Respondents can indicate for limiting factors "shortage of labour force".
Source: a) European Commission, 2021 Labour market and wage developments in Europe report (forthcoming)
b) Eurostat, LFS and European Commission, EU-BCS

([1]) For a more in-depth discussion of recent labour market developments, see European Commission, 2021 Labour Market and Wage Developments in Europe report (forthcoming).

([2]) Thanks to the extensive use of job retention schemes, the downturn was reflected more in a drop in hours worked in 2020 (-5.5%) than in an increase in unemployment. GDP contraction was deeper in 2020 than in 2009 (-4.3%), but the increase in unemployment was sizeably lower (monthly unemployment rates increased by up to 2.6 pp in the EU between 2008 and 2009).

([3]) In March 2021, the European Commission set a new EU-level target to reduce the number of people at risk of poverty or social exclusion by at least 15 million by 2030. It is one of the three headline targets in the areas of employment, skills, and social inclusion to be achieved by 2030 as part of the European Pillar of Social Rights Action Plan.

([4]) In March 2021, the Commission adopted a Recommendation for Effective Active Support to Employment (EASE), to invite Member States to implement coherent packages of strengthened active labour market policies to support job transitions in the recovery. In line with the EASE recommendation, active labour market policies and public employment services are an integral part of the RRPs of 20 Member States, while all Member States included up- and re-skilling policies into their plans.

([5]) For a more in-depth discussion of skills, see European Commission (2021), Proposal for a Joint Employment Report 2022 from the Commission and the Council.

([6]) See: Croitorov O. et al. (2021), "The macroeconomic impact of the COVID-19 pandemic in the euro area" *Quarterly Report on the Euro Area*, DG ECFIN, European Commission, Vol. 20, No 2, Part I. See also the 2021 report of the Employment and Social Developments in Europe (ESDE) and Fasani, F., Mazza, J. (2020) A vulnerable workforce: migrant workers in the Covid-19 pandemic. JRC Technical report

([7]) Employment and Social Developments in Europe (ESDE) Annual Review 2021.

3. SUMMARY OF MAIN CHALLENGES AND SURVEILLANCE IMPLICATIONS

The COVID-19 crisis interrupted the correction of macroeconomic imbalances related to high government, private and external debts, and came at the time when overheating risks were emerging in some countries after several years of strong growth. The pandemic-induced recession stopped a broad process of deleveraging from high government and private sector indebtedness that had taken place in a number of Member States over most of the past decade, especially its second half when economic growth became stronger and helped bring debt ratios down. Large current account deficits or buoyant credit growth had also been corrected, resulting in external liabilities being gradually reduced and banking systems being strengthened. In more recent years, there had been a build-up of challenges and risks associated with signs of overheating in some sectors in some countries, mainly at the level of house prices and cost competitiveness, especially where economic growth was more buoyant, and after a relatively long economic expansion. Trends in house prices that were starting to gain pace prior to the COVID-19 crisis continued and in some cases even accelerated during the pandemic. Cost competitiveness was deteriorating in some of the faster growing countries prior to the pandemic and more recent developments are still hard to assess as the available data are still distorted by the unusual fall in productivity in 2020 and the interplay with extensive labour market support measures.

A number of imbalances have been exacerbated by the COVID-19 crisis and new challenges may be looming. In 2020, government and private sector debt-to-GDP ratios rose sharply due to the recession and to higher borrowing to mitigate the fallout of the crisis. However, thanks to the marked economic recovery, debt ratios are now stabilising or have already started declining. Nonetheless, the crisis leaves a legacy of higher debt as governments are coming out of the crisis with clearly higher debt-to-GDP ratios. The private sector, mostly in countries where private debt was already high prior to the crisis, is also burdened with higher debt. The successful implementation of the recovery and resilience plans can support public and private deleveraging by helping to enhance long-term growth. However, in the short term, a deterioration in government and private asset quality may affect the balance sheets of financial institutions, whose low profitability has fallen further under the pandemic, and impair credit supply for the recovery. External accounts have been less affected but deteriorated for countries where cross-border tourism is more significant, including some with large negative net international investment positions. At the same time, housing markets have gained further dynamism over this crisis and house price growth is at its highest since over a decade in several Member States. The risks of house price overvaluation are rising, which raises concerns particularly where household debt is high. Cost competitiveness pressures may be picking up strongly with the recovery, especially in countries less affected by the crisis.

Overall, challenges are present in a number of Member States. The main challenges relate to:

- A number of Member States are affected by *multiple and interconnected stock vulnerabilities*. This is typically the case for those countries that were hit by boom-bust credit cycles coupled with current account reversals following the global financial crisis, which also had implications for the banking sector and for government debt. Nearly all of those Member States have been hit hard by the COVID-19 crisis, reflecting also the high relevance of cross-border tourism in their economies:

– In the case of Cyprus and Greece, elevated debts and large negative net international investment positions combine with lasting challenges for the financial sectors. The current accounts of these Member States worsened in 2020 on the back of falling travel and tourism revenues. Although further progress was observed in reducing non-performing loans in 2020, they remain high in both countries. In the case of Greece, potential output growth has been slow in a context of high unemployment.

– In Croatia, Ireland, Portugal, and Spain, imbalances related to high debts were receding until the outbreak of the COVID-19 crisis. However, in Croatia, Portugal and Spain these trends were interrupted by the pandemic-induced recession and debt-to-GDP ratios edged up visibly. In 2020,

Ireland stood out by avoiding a recession in GDP while the sector composition of its economy had a favourable impact on its external accounts.

- In Romania and Hungary, vulnerabilities mainly relate to the *interplay between government debt and external financing* against a backdrop of overheating risks and large fiscal deficits. In Romania, the current account deficit has been significant and persistent for a number of years and no improvement is expected in the near future. Government debt has been rising fast since before the COVID-19 crisis reflecting large fiscal deficits, and is set to further increase adding to external financing needs. In Hungary, government financing needs have been large in recent years, and will remain so, in light of short debt maturities and large fiscal deficits, and the source of such financing is partly external. In both countries, a non-negligible share of debt is denominated in foreign currency, which compounds the links between the external sector and the fiscal situation. In the case of Hungary, house prices are edging up sharply and inflationary and cost competitiveness pressures are visible against the backdrop of a strong recovery and lasting policy support.

- In a few Member States, vulnerabilities are mainly linked to *large government debt-to-GDP ratios that have further increased during the crisis* coupled with lasting concerns relating to *potential output growth* and *competitiveness*. This is particularly the case for Italy, where vulnerabilities are also linked to the banking sector and the large, even if still declining in 2020, stock of non-performing loans, and in a context of lasting weak labour market performance. Belgium and France mainly face issues linked to high government debt that increased markedly with this latest crisis, and potential growth issues amidst weak competitiveness. In France, private debt continued to rise from already relatively high levels, in particular corporate debt. In Belgium, the high private debt also grew further in 2020. In both Belgium and France, house prices may be overvalued and became more dynamic recently.

- Some Member States are characterised by *large current account surpluses* that remain above levels that economic fundamentals would justify. This is the case for Germany and the Netherlands. The euro area surplus is expected to edge up this year, following a temporary decline last year. The large surpluses may reflect forgone growth and domestic investment opportunities. That may have consequences for the functioning of the euro area in a context of a recovery that needs to be sustained against a backdrop that is still marked by significant uncertainty. In both cases, house price dynamics point to risks of overvaluation, which in the case of the Netherlands have been there for a number of years and are accompanied by high household debt.

- In Czechia and Slovakia, *cost competiveness losses have combined with strong house price growth* for some years. Cost competitiveness losses had been recorded before the crisis and continued marked growth in employee compensation point to overheating risks amid continued large fiscal deficits, with government debt being higher in Slovakia. The performance of the external sector of these countries does not seem to have been affected but the significant concentration of exports in a few specific sectors constitutes a vulnerability. These are compounded by strong house price growth, with increasing risks of house price overvaluation. In the case of Slovakia, these come alongside relatively high household debt following years of increases.

- In some Member States, developments in the housing markets are adding to *risks linked to house prices valuations* often in a context of high household debt. That is the case of Sweden, and also of Denmark and Luxembourg. Recent house price data suggest that after some short-lived downward adjustment house prices in Sweden accelerated again in 2020, reinforcing overvaluation concerns. In Luxembourg, buoyant house price growth has become even more dynamic during the crisis, which has compounded risks of overvaluation and occurs alongside high household debt relative to household gross disposable income. In Denmark, the very recent acceleration in house prices occurred alongside high household debt.

- In the case of Malta, an elevated and growing private debt stock and persisting weaknesses of the insolvency framework create particular vulnerabilities.

This AMR concludes that IDRs are warranted for 12 Member States: Croatia, Cyprus, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Romania, Spain, and **Sweden.** These Member States were subject to an IDR in the previous annual cycle of MIP surveillance, and were considered to be experiencing imbalances (Croatia, France, Germany, Ireland, the Netherlands, Portugal, Romania, Spain, and Sweden) or excessive imbalances (Cyprus, Greece, and Italy). The new IDRs will assess if those imbalances are aggravating, under correction, or corrected, with the view to update existing assessments and assessing possible remaining policy needs.

In addition, a number of Member States that were not subject to an IDR in the previous round display developments that merit particular attention. Slovakia is marked by strong house price growth alongside a sustained albeit slowing increase in household borrowing. Exports are markedly concentrated in a few specific sectors and there have been cost competitiveness losses, but export market shares have so far not been adversely affected. In the case of **Hungary**, the interplay between government borrowing and external financing in a context of significant debt exposure in foreign currency merits attention. House price growth has been strong. Cost competitiveness pressures are mounting, but export market shares have so far not been adversely affected.

There is also the need to monitor the development of risks in other Member States, in many instances linked to housing markets. In the case of Denmark and Luxembourg, developments in the housing market point to a build-up of risks. While changed preferences, supportive financial conditions and supply constraints may sustain house price growth, the risk of a downward correction, with potential implications for the wider economy, cannot be dismissed. Czechia is marked by strong house price growth and persistent cost competiveness losses that have been significant for some years. In Malta, growing private debt combined with weaknesses of the insolvency framework create particular vulnerabilities. Monitoring and surveillance should follow developments closely in these six Member States and ascertain whether they are consistent with and conducive to macroeconomic stability. The balance of risks does not at present point to a need for an IDR. Section 4 provides more information on country-specific developments.

4. MEMBER STATES SPECIFIC COMMENTARIES

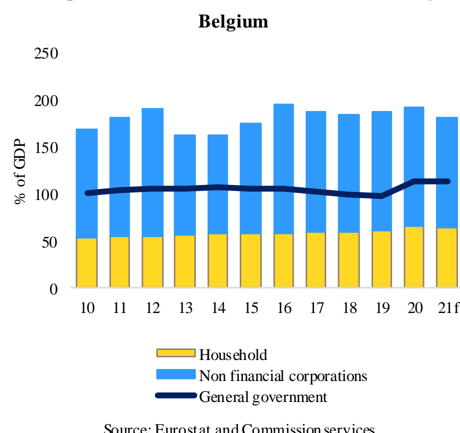
4.1. BELGIUM

In June 2021, no macroeconomic imbalances were identified in Belgium. In the updated scoreboard including figures until 2020, the indicators for private sector consolidated debt and general government gross debt indicators are above their indicative thresholds.

After a 5.7% contraction in 2020, real GDP is forecast to increase by 6% in 2021 and 2.6% in 2022. The nominal GDP level in 2022 is forecast to be 8.4% above its 2019 level.

Relevant developments since the previous report can be summarised as follows:

Graph A1: Debt across sectors in the economy



Source: Eurostat and Commission services

- **External vulnerabilities** remain limited. In 2020, the current account recorded a small surplus. The NIIP is clearly positive, and is forecast to remain at broadly the same level in 2021 and 2022. The marked increase in the unit labour cost (ULC) in 2020 reflects the large drop in productivity during the COVID-19 crisis, partly due to labour hoarding. In 2021 and 2022, pay dynamics are expected to largely offset the recuperation in productivity.
- The **private sector debt**-to-GDP ratio increased further above the threshold in 2020. It was negatively affected by the sharp decline in GDP in 2020. The debt of Belgian non-financial corporations is high and increased to almost 126% of GDP, but the high share of cross-border intra-group lending, which inflates this figure, reduces risks. Household indebtedness, which mainly reflects mortgage debt, continued to increase in 2020, but the rise in the household debt-to-GDP ratio is mostly due to the drop in GDP, as net credit flows to households were contained. Measures to support household and firm income have contributed to the stabilisation in the share of non-performing loans in 2020. House price growth accelerated in 2020 and house prices show signs of potential overvaluation.
- The **government debt-to-GDP** ratio further increased in 2020, to 112.8% of GDP, reflecting the sharp drop in GDP and the substantial government support measures to mitigate the impact of the COVID-19 crisis. Risks associated to financial and public sector feedback loops remain limited. The financial sector remains sound.
- The increase in the **unemployment rate** was contained in 2020, increasing only slightly to 5.6%, thanks to government support measures, which have been prolonged until the end of 2021. It is forecast to increase slightly in both in 2021 and 2022. Youth unemployment increased in 2020, and is forecast to increase to 20.5% in 2021.

Belgium entered the COVID-19 crisis with no identified macroeconomic imbalances, although with a high private sector and general government gross debt, involving limited risks. With the COVID-19 crisis, debt, both for the private and public sector, has further increased and warrant monitoring. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.2. BULGARIA

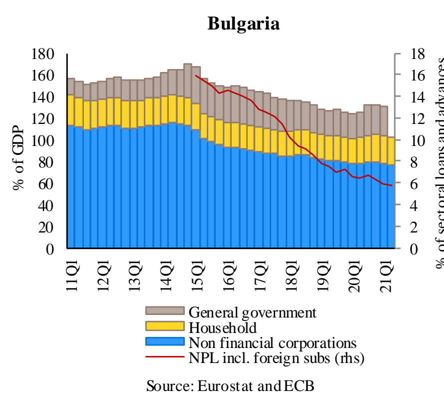
In June 2021, no macroeconomic imbalances were identified in Bulgaria. In the updated scoreboard including figures until 2020, the unit labour cost (ULC) growth indicator is above their indicative thresholds.

After contracting by 4.4% in 2020, real GDP is expected to grow by 3.8% in 2021 and by 4.1% in 2022. With the return to economic expansion, nominal GDP in 2022 is forecast to be 17% above its 2019 level.

A number of relevant developments can be summarised as follows:

- The **current account** balance registered a small deficit of 0.3% of GDP in 2020, for the first time since 2012. Its decline was mainly due to the contraction of exports of tourism services caused by the COVID-19 pandemic. A recovery of tourism revenues has started in 2021 and is expected to continue in 2022. The negative NIIP, largely consisting of foreign direct investment, continued to improve on account of further accumulation of reserve assets.

Graph A2: Debt decomposition by sector



Source: Eurostat and ECB

- **Nominal unit labour costs** increased further in 2020 driven by somewhat lower headline productivity in a context of labour hoarding. Going forward, unit labour costs are expected to continue increasing markedly even if less than in 2020, despite recovering productivity growth, as compensation per employee is set to increase strongly.

- **Corporate indebtedness increased** in 2020, but deleveraging is expected to resume with the economic recovery. Although credit growth moderated, the sharp decline of GDP in 2020 temporarily reversed the process of debt deleveraging that had been based on strong nominal GDP growth. With the return of economic growth, the corporate debt-to-GDP ratio should return to a downward path. The real growth rate in **house prices** increased to 5.2% in 2020. It is set to moderate somewhat in 2021, but is supported by buoyant mortgage credit growth.

- **Government debt** was below 25% of GDP in 2020 and is set to remain below 30% of GDP in 2021 despite the planned increase of government expenditure.

- **The financial sector** maintained sufficient liquidity and capital adequacy during the COVID-19 crisis, supported by the measures the Bulgarian National Bank introduced in March 2020 and the entry of Bulgaria into the Banking Union in July 2020. The non-performing loans ratio remains high, although it declined further to 5.9% in 2020. It will be important going forward to monitor closely the effect of the phasing out of public support measures, such as the loan moratoria and the guarantee schemes.

- **The labour market conditions** were not particularly affected by the recession in 2020 largely thanks to the use of short-time work schemes. The unemployment rate increased to 5.1% in 2020 from a historical low level in 2019, but is forecast to start declining as of 2022.

Bulgaria entered the COVID-19 crisis with no identified macroeconomic imbalances, although non-performing loans and corporate indebtedness were relatively high, albeit declining. With the COVID-19 crisis, the private sector debt-to-GDP ratio increased temporarily in 2020, but is set to decline afterwards. Wage compensation is expected to continue its pre-pandemic growth path. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.3. CZECHIA

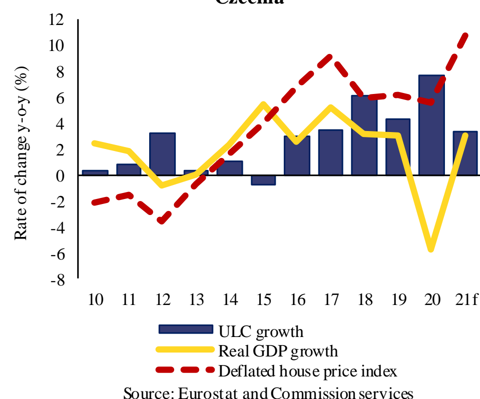
In June 2021, no macroeconomic imbalances were identified in Czechia. In the updated scoreboard including figures until 2020, the unit labour cost (ULC) growth indicator is above their indicative thresholds.

After a GDP decline of 5.8% in 2020, real GDP is forecast to increase by 3% in 2021 and 4.4% in 2022. With the return to economic expansion, nominal GDP in 2022 is forecast to be 13.2% above its 2019 level.

A number of relevant developments can be summarised as follows:

- **External vulnerabilities** remained contained. While a current account surplus of 3.6% of GDP was recorded in 2020, it is expected to move back to a broadly balanced position in 2021. The NIIP continued improving but remained mildly negative, at -12.5% of GDP in 2020. The NIIP excluding non-defaultable instruments (NENDI) was already positive and has also been improving.
- **Unit labour cost** growth was already high before the pandemic. It accelerated further in 2020 on the back of labour hoarding associated with the COVID-19 crisis. With the recovery in productivity, ULC growth is expected to moderate despite strong growth in compensation per employee in 2021 and 2022.

Graph A3: GDP, ULC and house prices



Source: Eurostat and Commission services

- **Private indebtedness** remained low. While it increased slightly in 2020, private debt remains well within the prudential and fundamental benchmarks. Credit flows have been positive but limited for both households and companies. The **banking sector** is well capitalized and its profitability is high. The non-performing loans ratio remains low.
- **General government debt** increased to 37.7% of GDP in 2020 and is forecast to rise to 42.4% of GDP in 2021 and 44.3% in 2022. While the level of government debt is still relatively low, it grows at a high pace amid large budget deficits.
- **House prices** have been growing briskly over an extended period of time, with increasing indications of potential overvaluation. Real house price growth remained high in 2020, at 5.5%, although it dipped below the scoreboard threshold. With household disposable income expected to continue growing strongly in 2021-22, a further acceleration of house prices seems likely, as also suggested by available data for 2021. Upward price pressures could be mitigated by an expected pick-up of residential construction in 2021 and 2022 and rising mortgage interest rates amid ongoing monetary tightening.

Czechia entered the COVID-19 crisis with no identified macroeconomic imbalances, although competitiveness and pressures in the housing market involved some risks. With the COVID-19 crisis, some risks have increased. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.4. DENMARK

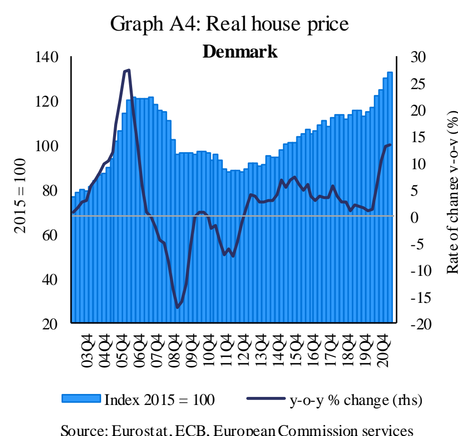
In June 2021, no macroeconomic imbalances were identified in Denmark. In the updated scoreboard including figures until 2020, the current account surplus and the private sector debt indicators are above their indicative thresholds.

After a 2.1% decrease in 2020, real GDP is forecast to increase by 4.3% in 2021 and 2.7% in 2022. The nominal GDP level in 2021 is forecast to surpass its 2019 level by around 10.4%.

A number of relevant developments can be summarised as follows:

- **Regarding external sustainability,** the current account balance continues showing a large surplus, which came in at 8.1% of GDP in 2020. Even though expected to steadily decline in the coming years, it is forecast to remain clearly above the upper MIP threshold. The high surplus mainly reflects high corporate and pension savings. Accumulated current account surpluses have led to a high net international investment position (NIIP) that reached almost 69% of GDP in 2020, which is down from about 77% of GDP in 2019 due to valuation changes. The large NIIP generates positive net primary income, which in turn reinforces the positive current account balance.

Graph A4: Real house price



Source: Eurostat, ECB, European Commission services

- **Private sector** indebtedness remains high but is decreasing. Danish households have been deleveraging over recent years, although the **household debt** ratio increased marginally to 111.7% of GDP in 2020, affected by the decline in real GDP. The household debt-to-GDP ratio is the highest in the EU but is projected to continue decreasing in 2021 as a share of GDP. Despite accelerating house prices, the increase in mortgage lending remained moderate. The interest burden reduced further while the share of loans with variable rates remains relatively high, although much lower than a decade ago. The high level of household gross debt is accompanied by significantly higher, albeit less liquid, financial assets, notably houses and pension savings.

- **Real house price** growth was 4.6% in 2020, below the threshold in the scoreboard. Real house price growth increased in the first half of 2021, reaching the peak of 13.5% year on year in the second quarter of 2021 but it is forecast to decelerate in the near future. Valuation gap estimates indicate potential overvaluation. The average house price gap continues to increase, and the price to income gap is comparatively high.

- **The banking sector** has remained stable and banks remain profitable, liquid, and well capitalised, while the non-performing loans ratio is low. Despite a sharp increase in 2020 due to the implementation of COVID-19-related measures, **government debt** is relatively low at around 42% of GDP. The budget deficit was only 0.2% of GDP in 2020, partly due to one-off effects.

- The **labour market** has remained strong. The unemployment rate increased slightly in 2020 to 5.6%. Due to the strong recovery of the Danish economy, employment exceeded the pre-pandemic level, and the number of unemployed went below the pre-pandemic level by 2021 Q2.

Denmark entered the COVID-19 crisis with no identified macroeconomic imbalances, although the high private sector indebtedness and current account surplus involve some risks. During the COVID-19 crisis, private sector indebtedness has increased moderately, while house prices have risen markedly, and the current account surplus has remained high. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.5. GERMANY

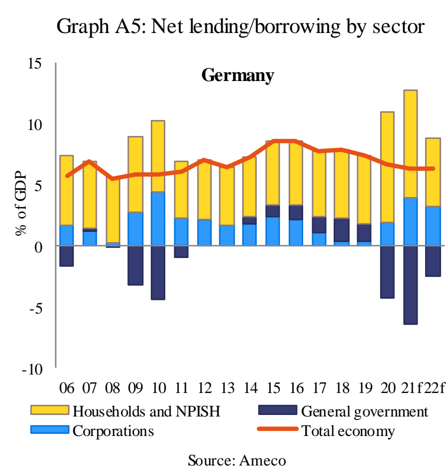
In June 2021, the Commission concluded that Germany was experiencing macroeconomic imbalances, reflecting a subdued level of investment relative to savings, which have cross-border relevance. In the updated scoreboard, which includes figures until 2020, the current account balance, unit labour cost (ULC) growth, house price growth, and government debt indicators are above their indicative thresholds.

After a 4.6% decrease in 2020, real GDP is forecast to increase by 2.7% in 2021 and 4.6% in 2022. The nominal GDP level in 2022 is forecast to be 9.4% higher than in 2019.

A number of relevant developments can be summarised as follows:

- The **current account surplus,** standing at 6.9% of GDP in 2020, remains high. It has gradually narrowed since 2015, but is forecast to persist above 6%. This is linked to subdued private and public investment, which are constrained among others by bottlenecks to investment, such as in infrastructure and housing. While private and public investment have gradually increased in recent years, they remain below the euro area average.

Graph A5: Net lending/borrowing by sector



Source: Ameco

- **Unit labour costs** increased sharply in 2020 due to the strong decline in output combined with relatively stable employment and compensation. The relationship between labour cost and output is expected to normalise as GDP recovers.
- **Government debt** exceeded the indicative scoreboard threshold of 60% of GDP, rising to 68.7% of GDP in 2020 and is expected to peak at 71.4% in 2021, reflecting policy support during the COVID-19 pandemic. The **banking system** remains adequately capitalised with a very low level of non-performing loans, although its profitability is low after a further decline in 2020.
- **Real house prices** grew by 7.1% in 2020 and continued to grow briskly in the first half of 2021 amid a continued shortfall in housing supply. House price developments show signs of potential overvaluation.

Germany entered the COVID-19 crisis with a large domestic savings surplus, underpinned primarily by net savings of households and the government. The current account surplus persists at a high level, as private investment remains muted despite policy support in the COVID-19 context, and public investment has not yet filled longstanding investment gaps. House prices have grown strongly. Overall, the Commission finds it opportune, also taking into account the identification of imbalances in June, to examine further the persistence of imbalances or their unwinding.

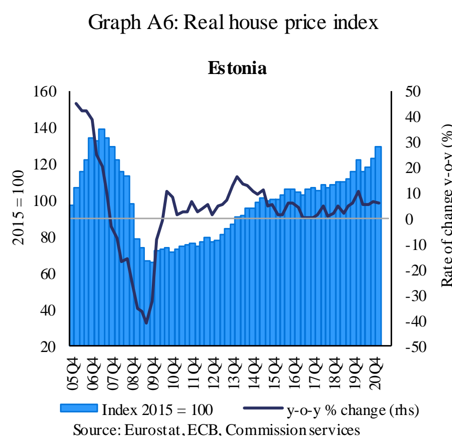
4.6. ESTONIA

In June 2021, no macroeconomic imbalances were identified in Estonia. In the updated scoreboard including figures until 2020, real effective exchange rate, unit labour cost (ULC) growth, house price growth, financial sector liabilities and the youth unemployment rate indicators are above their indicative thresholds.

After a 3% decrease in 2020, real GDP is forecast to increase by 9% in 2021 and 3.7% in 2022. The nominal GDP level in 2022 is forecast to be 16% above its 2019 level.

A number of relevant developments can be summarised as follows:

Graph A6: Real house price index



Source: Eurostat, ECB, Commission services

- **External vulnerabilities** remain contained, with the NIIP forecast to stabilise at around -22% of GDP in 2021, after a decade of steady improvements. The accumulated stock of FDI represents most of the liabilities. The current account recorded a small deficit in 2020, which is expected to slightly increase in 2021.
- **Unit labour cost growth** accelerated further in 2020 after some years of continued strong growth. Unit labour costs are forecast to decrease in 2021 thanks to higher productivity in times of buoyant output growth and a lagged employment response, and to start increasing again thereafter. Export market shares expanded until 2020, driven by exports of goods, and are expected to continue rising, albeit at a slower pace going forward. The HICP-based real effective exchange rate appreciated marginally last year, although less than in some of the pre-pandemic years.
- Growth in **house prices** accelerated to 6.9% in 2020 and is expected to accelerate further in 2021, fuelled by the early withdrawal of pension assets in 2021, increasing construction material prices and supply-side bottlenecks, while households' borrowing constraints could be a mitigating factor. House price metrics do not point to potential overvaluation risks. The **banking sector** remains resilient with a high capital ratio and a low non-performing loans ratio.
- **The government debt** to GDP ratio remains low, but rose by 10 pps in 2020, due to a higher public deficit, lower nominal GDP and precautionary financing by the government. It is forecast to reach 20.4% of GDP in 2022.
- The **labour market** conditions deteriorated in the wake of the COVID-19 crisis. After a steady decrease over the past decade, the unemployment rate rose to 6.8% in 2020. It is forecast to start falling in 2022. The youth unemployment rate increased markedly in 2020, and it is expected to continue increasing in 2021.

Estonia entered the COVID-19 crisis with no identified macroeconomic imbalances, although with a negative net international investment position involving limited risks. With the COVID-19 crisis, house price growth has accelerated but house prices do not appear to be overvalued. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

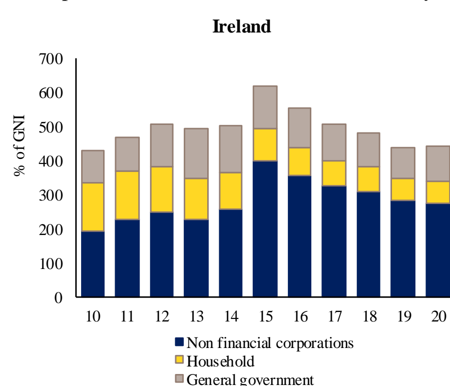
4.7. IRELAND

In June 2021, the Commission concluded that Ireland was experiencing macroeconomic imbalances, in particular involving vulnerabilities linked to high private, public and external debt. In the updated scoreboard including figures until 2020, the current account balance, the net international investment position, private sector debt and the activity rate indicators are above their indicative thresholds.([40])

After an expansion of 5.9% in 2020, Ireland's economic growth is expected to accelerate to 14.6% in 2021 followed by 5.1% in 2022. The nominal GDP level in 2022 is forecast to be 28.1% above its 2019 level.

A number of relevant developments can be summarised as follows:

Graph A7: Debt across sectors in the economy



Source: Eurostat and CSO
Note: Modified Gross National Income (GNI*) captures more accurately the underlying economic activity by eliminating some of the impact of multinationals

- **External sustainability** remains a concern. The NIIP is strongly negative, though heavily inflated by activities of multinational companies. It improved to -174% GDP in 2020 and is expected to further improve going forward. The current account rebounded in 2020 from a huge deficit in 2019, and is projected to record a large surplus in 2021 and 2022, contributing to the improvement of the external position.
- **Private debt** is very high but continues to fall. It reached almost 189% of GDP in 2020. Corporate debt accounts for the majority of the private debt (153% of GDP and 274% of modified Gross National Income (GNI*)) and remains above fundamental and prudential thresholds. The high share of cross-border intra-group lending in corporate debt reduces risks. In 2020, household debt reached about 36% of GDP and 64% of GNI*. While below the prudential threshold and declining, it is still high relative to household disposable income (109%).
- **Government debt** increased slightly, to 58.4% of GDP in 2020. It is expected to resume its declining trend in 2021. In contrast, the government debt relative to GNI* remains large.
- The **banking sector** is in a healthier position than in the run up to the 2010 financial crisis. Banks are well-capitalised but face longer-term challenges related to profitability, which turned negative in 2020. Non-performing loans (NPLs) have reduced substantially over the past years and the NPL ratio remained low, at 2.6% in June 2021.
- **House prices** were stagnant in 2020 in real terms, but are expected to pick up slightly in 2021 driven by supply shortfalls. Valuation gap metrics do not point to potential overvaluation, but housing affordability remains an issue, with the average number of years of income required to buy a dwelling being among the highest in the EU.
- The **unemployment rate** increased to 5.7% in 2020 and is forecast to rise to 7.5% in 2021 as a result of the COVID-19 crisis, but is likely to start falling again thereafter. The three-year change in the activity rate turned negative in 2020, but is forecast to be again positive in 2021 and 2022.

Ireland entered the COVID-19 crisis with vulnerabilities linked to external, private sector and government debt. As Ireland's economy grew despite the crisis, vulnerabilities linked to external and private debt eased somewhat, but government debt has increased. Overall, the Commission finds it opportune, also taking into account the identification of imbalances in June, to examine further the persistence of imbalances or their unwinding.

[40] The Post-Programme Surveillance (PPS) report from autumn 2021 for Ireland also discusses some of the vulnerabilities highlighted in the AMR.

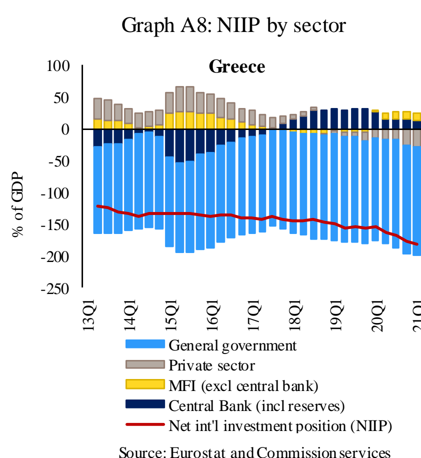
4.8. GREECE

In June 2021, the Commission concluded that Greece was experiencing excessive macroeconomic imbalances, relating to high government debt, incomplete external rebalancing and high non-performing loans, in a context of high unemployment and low potential growth. In the updated scoreboard, including figures until 2020, a number of indicators are above their indicative thresholds, namely the net international investment position (NIIP), the government debt, the export market share, the financial sector liabilities, the unemployment rate and the activity rate. ([41])

After a sharp contraction by -9% in 2020, real GDP is forecast to rebound, with growth expected to reach 7.1% in 2021, 5.2% in 2022. The nominal GDP level in 2022 is forecast to be 2.4% higher than in 2019.

A number of relevant developments can be summarised as follows:

Graph A8: NIIP by sector



Source: Eurostat and Commission services

- **External sustainability** worsened in 2020 as the negative NIIP ratio fell further on account of the contraction in GDP and the marked deterioration of the current account deficit to -6.6% of GDP. With the return of tourism, the current account deficit is forecast to narrow in 2021 and 2022. A large share of the NIIP is accounted for by government debt extended at concessional terms and long maturities.
- The **government debt**-to-GDP ratio increased by 26 pp. in 2020, to 206.3% of GDP, reflecting the depth of the recession and the impact of the measures to limit the economic and social cost of the COVID-19 crisis. Over half of this increase was due to the denominator effect. The government debt ratio is forecast to start decreasing in 2021. Long-term gross financing needs have not changed significantly since the beginning of the pandemic, mainly due to the decrease in the refinancing rates.
- **Banking sector** profitability turned negative in 2020 and the common equity tier 1 capital ratio is one of the lowest in the EU, partly due to the ongoing clean-up of banks' balance sheets. While still high, at 26.1% in March 2021, the non-performing loans ratio ([42]) decreased markedly in 2020 and is expected to continue falling at slow pace in 2021. Following the expiry of the moratoria, an initial assessment shows a moderate adverse impact on asset quality, but downside risks remain.
- The **unemployment rate** continued declining even during the pandemic, mainly due to government support measures, but remained high at 16.3% in 2020. It is forecast to further decline over the forecast horizon.

Greece entered the COVID-19 crisis with vulnerabilities linked to government debt, incomplete external rebalancing, legacy non-performing loans, unemployment and low potential growth. With the COVID-19 crisis, government debt, and external imbalances have increased. Overall, the Commission finds it opportune, also taking into account the identification of excessive imbalances in June, to examine further the persistence of macroeconomic risks and to monitor progress in the unwinding of excessive imbalances.

([41]) Some of the vulnerabilities highlighted in this AMR are discussed in the 12th enhanced surveillance report for Greece.
([42]) According to the European Central Bank, non-performing loans as a share of total gross loans and advances on a consolidated basis (i.e. including cash balances at central banks and other demand deposits in the denominator). This figure is different than the one reported under enhanced surveillance, which follows non-performing loans as a share of total gross customer loans on a solo basis, as reported by the Bank of Greece.

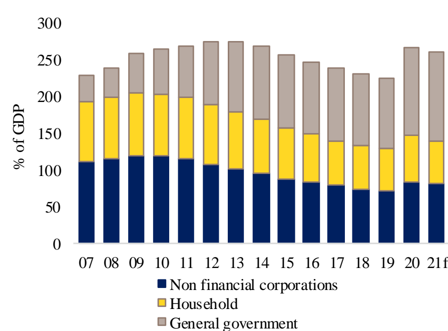
4.9. SPAIN

In June 2021, the Commission concluded that Spain was experiencing macroeconomic imbalances, relating to high levels of external, private and government debt, which have cross-border relevance, in a context of high unemployment. In the updated scoreboard including figures until 2020, a number of indicators are above their indicative thresholds, namely the net international investment position (NIIP); unit labour cost (ULC) growth, the export market share, the government debt and private sector debt, the unemployment rate as well as the activity rate.

After a 10.8% decrease in 2020, real GDP is forecast to increase by 4.6% in 2021 and 5.5% in 2022. The nominal GDP level in 2023 is forecast to be 2.6% above its 2019 level.

A number of relevant developments can be summarised as follows:

Graph A9: Decomposition of debt by sector



Source: Eurostat and Commission services

- **External sustainability** worsened in 2020 as the negative NIIP-to-GDP ratio widened, mainly due to the contraction in GDP but also some negative valuation changes. The NIIP ratio reached -85.5% in 2020, but is forecast to improve in 2021 and 2022. The NIIP net of non-defaultable instruments (NENDI) remains sizeable. The current account surplus declined to 0.8% of GDP in 2020 accompanied by a deterioration in the export market share, partly due to the weak international tourism. The current account is projected to be slightly in surplus in 2021 and 2022.

- **Corporate and household indebtedness** had been on a declining path until 2019. With the COVID-19 crisis, the private debt-to-GDP ratio increased to slightly above146% of GDP in 2020, reflecting both the net credit flows to the corporate sector and, to a larger extent, the sizeable fall in GDP, thereby exceeding the MIP threshold of 133%. The increase in the private debt-to-GDP ratio is likely to be partly reversed in 2021, due to the expected economic recovery.

- The already high **government debt**-to-GDP ratio increased by 25 pp. in 2020, reaching 120% of GDP, reflecting the depth of the recession and the impact of the government support measures undertaken in response to the COVID-19 crisis. It is forecast to decline moderately by 2022, reaching 116%. Risks associated to negative financial and public sector feedback loops remain and may be amplified by increasing vulnerabilities in the corporate sector related to the pandemic

- The **banking sector** enhanced its resilience during the past decade. Through the COVID-19 crisis, banking sector capitalisation has marginally improved, although it is still low. The liquidity position of banks has remained reassuring. Profitability has been persistently low and turned negative in 2020. The non-performing loans ratio decreased to 2.8% in 2020. However, it may increase going forward, once the effect of the phasing out of public support measures, such as the loan moratoria and the guarantee schemes, will be fully visible.

- After declining for several years, the **unemployment** rate increased again in 2020 to 15.5%, in the context of the COVID-19 crisis and remains above the indicative threshold. The unemployment rate is forecast to decrease in 2021 and 2022. The activity rate decreased and remains below the indicative threshold. In addition, labour market segmentation remains of concern.

Spain entered the COVID-19 crisis with vulnerabilities linked to external, private sector and government debt and high unemployment. With the COVID-19 crisis, debt ratios and unemployment have increased. Overall, the Commission finds it opportune, also taking into account the identification of imbalances in June, to examine further the persistence of imbalances or their unwinding.

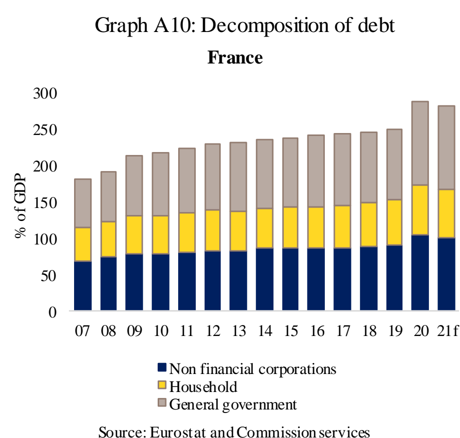
4.10. FRANCE

In June 2021, the Commission concluded that France was experiencing macroeconomic imbalances, relating to high government debt and weak competitiveness in a context of low productivity growth, which have cross-border relevance. In the updated scoreboard including figures until 2020, a number of indicators are above their indicative thresholds, namely, government and private sector debt, export market share as well as the activity rate.

After a decrease of 7.9% in 2020, real GDP is forecast to increase by 6.5% in 2021 and 3.8% in 2022. The nominal GDP level in 2022 is forecast to be 6.7% above its 2019 level.

A number of relevant developments can be summarised as follows:

Graph A10: Decomposition of debt



Source: Eurostat and Commission services

- **The external position** worsened in 2020, with the negative NIIP-to-GDP ratio decreasing to about -30% on the back of an increased current account deficit and the fall in GDP. The current account is set to improve somewhat in the coming years, with the expected rebound of exports. The NIIP is projected to stabilize around current levels.
- **The private debt-**to-GDP ratio continued to increase in 2020, by 21 pp., to almost 174%, supported by strong credit flows. This increase is set to be slightly reversed in 2021. However, rising corporate indebtedness is flanked by a parallel increase in corporate liquidity buffers, while rising household debt was also accompanied by an increase in deposits. Real **house prices** grew somewhat faster in 2020 than in 2019 and show signs of potential overvaluation.
- The already high **government debt**-to-GDP ratio increased by 18 pps. to 115% of GDP in 2020, reflecting the government support measures in response to the COVID-19 crisis and the depth of the recession. It is forecast to start declining in 2021.
- After several years of improvement, **competitiveness** metrics were adversely affected by the COVID-19 crisis. Unit labour cost growth temporarily increased in 2020, despite a fall in compensation per employee. This is expected to be only partially reversed in the coming years. The marked loss in export market shares in 2020 is set to be recovered over the coming years.
- The **banking sector** has shown healthy and rising equity levels, while the already low non-performing loans ratio continued declining in 2020, to 2.2%. However, this figure could increase with the gradual phasing out of government support measures.
- The **labour market** situation worsened in 2020 due to the COVID-19 crisis, with a decrease in total employment and the activity rate. Both the employment and the activity rates are expected to improve from 2021 onwards.

France entered the COVID-19 crisis with vulnerabilities linked to government debt and competitiveness in a context of low productivity. With the COVID-19 crisis, government, external and private debt stocks have increased. Overall, the Commission finds it opportune, also taking into account the identification of imbalances in June, to examine further the persistence of imbalances or their unwinding.

4.11. CROATIA

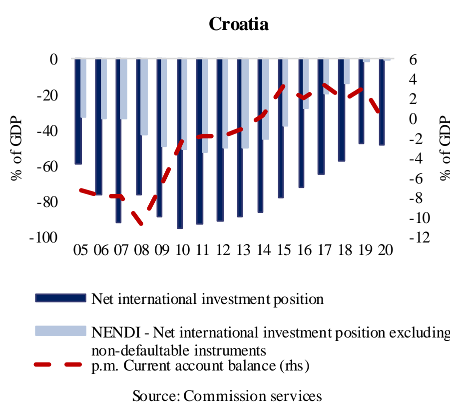
In June 2021, the Commission concluded that Croatia was experiencing macroeconomic imbalances, relating to high levels of external, private and government debt in a context of low potential growth. In the updated scoreboard including figures until 2020, the net international investment position (NIIP), unit labour cost (ULC) growth, house price growth and general government gross debt indicators are above their indicative thresholds.

After an 8.1% decrease in 2020, real GDP is forecasted to increase by 8.1% in 2021 and 5.6% in 2022. The nominal GDP level in 2022 is forecasted to be 9.5% above its 2019 level.

A number of relevant developments can be summarised as follows:

- **External sustainability** worsened in 2020. The current account turned to a deficit of 0.1% of GDP in 2020, mainly due to the pandemic-induced slump in tourism-related exports. The 3-year average surplus fell to 1.6%. The NIIP worsened slightly to -47.8% of GDP in 2020, but is expected to improve again from 2021 onwards. Conversely, the NIIP excluding non-defaultable instruments (NENDI) improved further and reached a balanced position in 2020.

Graph A11: NIIP, private debt and government debt



Source: Commission services

- **Nominal unit labour costs** accelerated in 2020 amid a productivity decline, pushing the 3-years change to 13.7%. ULC growth is forecast to turn negative in 2021.
- **The house price index** exceeded the threshold in 2020 again, with a growth of 7.3% in real terms, increasing the housing affordability problem. 2021 should bring a deceleration of house prices. House prices warrant further monitoring, also considering the developments in construction prices.
- **The private debt**-to-GDP ratio increased from about 88% of GDP to 98% in 2020, due to the GDP decline and positive albeit low credit flows. The increase in both the corporate and household debt ratios is likely to be reversed in 2021, due to the denominator (GDP growth) effect. While **the banking sector** is well capitalized and its profitability is high, it is also characterized by a relatively high non-performing loans ratio, above 5%.It will be important going forward to monitor closely the effect of the phasing out of public support measures, such as the loan moratoria and the guarantee schemes.
- After having declined for five consecutive years, the **government debt**-to-GDP ratio increased by 16 pp. in 2020, to 87.3% of GDP, reflecting the government support measures in response to the COVID-19 crisis and the depth of the recession. With expected economic recovery and withdrawal of fiscal support, the decline in government debt is forecast to resume in 2021.

Croatia entered the COVID-19 crisis with vulnerabilities linked to government, private sector and external debt in a context of low potential growth. With the COVID-19 crises, debt ratios have increased. Overall, the Commission finds it opportune, also taking into account the identification of imbalances in June, to examine further the persistence of imbalances or their unwinding.

4.12. ITALY

In June 2021, the Commission concluded that Italy was experiencing excessive macroeconomic imbalances, involving high government debt and protracted weak productivity dynamics, which have cross-border relevance, in a context of labour market and banking sector fragilities. In the updated scoreboard including figures until 2020, the government debt and the activity rate indicators are above their indicative thresholds.

After real output contracted sharply by 8.9% in 2020 as a result of the COVID19 crisis, real GDP growth is projected to rebound by 6.2% in 2021 and 4.3% in 2022. The nominal GDP level in 2022 is expected to exceed its 2019 level by 4.6%.

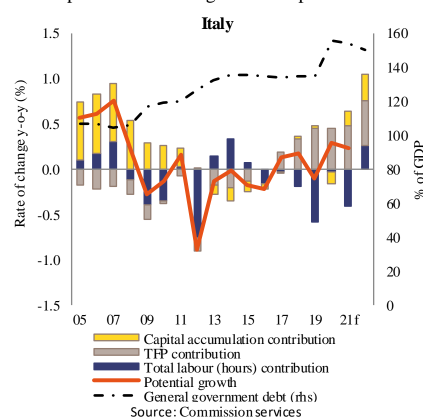
A number of relevant developments can be summarised as follows:

- The **external position** is stable with a balanced net international investment position (NIIP). The current account surplus of 3.8% of GDP in 2020 is expected to marginally decline in 2021, largely due to an increasing oil bill and stronger import demand.

- **Private debt** increased in 2020, with both household and corporate debt being close to the prudential and fundamentals based benchmarks. From 2021, both components of private debt are set to fall, with the resumption of growth.

- Labour **productivity** dropped sharply in 2020, as short-time work schemes buttressed employment, while economic output plummeted. Productivity is set to improve over the medium term, as GDP growth recovers. **Unit labour cost growth** increased in 2020 but is expected to slow down amid moderate wage growth going forward.

Graph A12: Potential growth and private debt



Source: Commission services

- The **government debt**-to-GDP ratio increased by 21 pps. in 2020, reaching 155.6%. Over half of the increase in the debt ratio is due to the denominator effect. The government debt ratio is expected to start declining in 2021, despite the prolonged policy support, and to remain on a downward path in the following years. Risks to public finances associated with financial and corporate sector feedback loops remain, given the sizeable share of publicly guaranteed loans and the risk of increasing corporate insolvencies, albeit from current low levels.

- Improvements have continued in the **banking sector**, but vulnerabilities remain. The reduction of the non-performing loans (NPLs) ratio has further progressed, but, at 4.5% in the first quarter of 2021, remains above the euro area average of 2.4%. The liquidity measures in response to the pandemic supported bank lending volumes. However, bank profitability has further declined in 2020.It will be important going forward to monitor closely the effect of the phasing out of public support measures, such as the loan moratoria and the guarantee schemes.

- The **unemployment rate** continued to decline in 2020, to 9.2%, unlike in most other EU countries, but is expected to increase in 2021. The youth unemployment rate increased further in 2020 and is very high. The size of the labour force is still smaller than before the COVID-19 crisis. Persistent skill mismatches could prevent a faster reduction of the unemployment rate in the coming years.

Italy entered the COVID-19 crisis with vulnerabilities linked to the high level of government debt and weak productivity growth, in a context of still relatively high unemployment. With the COVID-19 crisis, debt ratios have increased, while financial sector vulnerabilities and some vulnerabilities in the labour market remain. Overall, the Commission finds it opportune, also taking into account the identification of excessive imbalances in June, to examine further the persistence of macroeconomic risks and to monitor progress in the unwinding of excessive imbalances.

4.13. CYPRUS

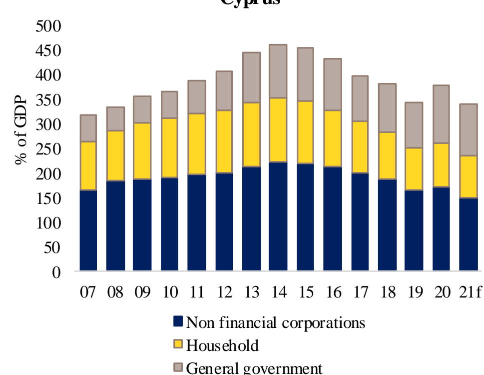
In June 2021, the Commission concluded that Cyprus was experiencing excessive macroeconomic imbalances. Vulnerabilities relate to high stocks of external, government, and private debt, and still high non-performing loans, alongside a substantial current account deficit. In the updated scoreboard including figures until 2020, a number of indicators are above their indicative thresholds, namely the current account, net international investment position (NIIP), government debt and private sector debt. ([43])

After a 5.2% decline in 2020, real GDP is forecast to increase by 5.4% in 2021 and 4.2% in 2022. The nominal GDP level in 2022 is forecast to be 7% above its 2019 level.

A number of relevant developments can be summarised as follows:

- **External vulnerabilities** remain a concern, as the NIIP remained significantly negative in 2020, even if largely reflecting activities of special purpose entities. The current account showed a large deficit of 10.1% of GDP in 2020, worsening from 5.7% in 2019, with tourism exports being very negatively affected by the pandemic. Moderate improvements are expected in 2021 and 2022.

Graph A13: Debt and non performing loans



Source: Eurostat and Commission services

- The **government debt**-to-GDP ratio increased by 24 pps in 2020, to 115.3%, as the government built a significant cash buffer to secure the necessary firepower to fight the pandemic, support the economy and manage liquidity risks. The government debt ratio is forecast to resume its declining path in 2021.
- After years of steady decline, the **private debt** ratio rose in 2020 due to the pandemic-induced fall in nominal GDP. The household debt ratio reached 91% of GDP, while the debt ratio of non-financial corporations increased to almost 170% of GDP. For 2021, building on the expected economic recovery, private indebtedness is projected to return to a declining path – remaining though above prudential and fundamental thresholds.
- **Banking sector** profitability turned negative in 2020. The stock of non-performing loans (NPLs) remains high, but declined significantly in 2020. The NPL ratio has remained stable at around 10% in the first half of 2021. Furthermore, additional portfolio sales have been planned. The lifting of the loan moratorium in January 2021 has not yet shown a significant adverse impact on asset quality, but it will be important going forward to monitor closely the effect of the phasing out of public support measures.

Cyprus entered the COVID-19 crisis with vulnerabilities linked to external, private sector and government debt. With the COVID-19 crisis, the current account deficit has deteriorated, while debt ratios have increased. Overall, the Commission finds it opportune, also taking into account the identification of excessive imbalances in June, to examine further the persistence of macroeconomic risks and to monitor progress in the unwinding of excessive imbalances.

([43]) The Post-Programme Surveillance (PPS) report from autumn 2021 for Cyprus also discusses some of the vulnerabilities highlighted in the AMR.

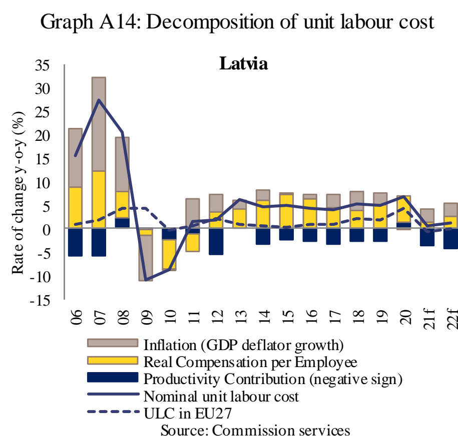
4.14. LATVIA

In the previous round of the MIP, no macroeconomic imbalances were identified in Latvia. In the updated scoreboard, a number of indicators are above their indicative thresholds, namely real effective exchange rate changes, and unit labour cost (ULC) growth.

After a 3.6% decrease in 2020, real GDP is forecast to increase by 4.7% in 2021 and 5% in 2022. The nominal GDP level in 2022 is forecast to be 12.9% above its 2019 level.

A number of relevant developments can be summarised as follows:

- The **current account** swung to a surplus of 2.9% of GDP in 2020, considerably improving the NIIP, which now stands at -34.7% of GDP, just below the MIP threshold. Latvia's negative NIIP consists mainly of government debt and foreign direct investment posing a low risk to sudden flight or appreciation in servicing cost. The current account balance is forecast to turn slightly negative again in 2022, but the NIIP is expected to continue improving.



Graph A14: Decomposition of unit labour cost

Source: Commission services

- **Cost competitiveness indicators** point to a continued weakening in 2020. Unit labour cost growth was already high before the pandemic, but increased further in 2020, due to the combination of declining productivity and continued wage growth. Wage growth remained high due to persistent skills shortages and because COVID-19 related job losses accrued predominantly in the low-wage sectors. COVID-19 related productivity effects are expected to be transitory but the wage pressures coming from falling labour supply are expected to remain a factor going forward as demographic decline is expected to persist. Latvia's export market share increased considerably in 2020. The HICP-based real effective exchange rate appreciated, considerably influenced by depreciation of the Russian rouble, which fell some 20% in 2020.

- **Real house price growth** slowed considerably in 2020, following several years of dynamic price growth. Private sector debt levels stayed stable, with subdued credit in the corporate sector. The **financial sector** is sound and well capitalised, but profitability deteriorated significantly in 2020.

- The **unemployment rate** increased to 8.1% in 2020, in light of the COVID-19 crisis. It is forecast to start declining in 2021. Also youth unemployment increased in 2020 and is forecast to increase further in 2021. The worsening in the labour market conditions due the COVID-19 crisis is expected to be temporary with the unemployment rate approaching its pre-crisis level by 2023.

Latvia entered the COVID-19 crisis with no identified macroeconomic imbalances, although with a negative net international investment position and high unit labour cost growth. Issues relating to labour supply pressures and cost competitiveness are expected to persist even beyond the COVID-19 crisis, but risks appear contained. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.15. LITHUANIA

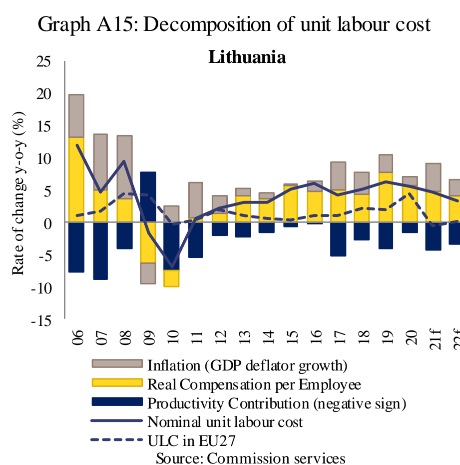
In the previous round of the MIP, no macroeconomic imbalances were identified in Lithuania. In the updated scoreboard, which includes figures until 2020, five indicators are above their indicative thresholds, namely the real effective exchange rate, unit labour cost (ULC) growth, house price growth, financial sector liabilities and the youth unemployment rate.

After a 0.1% decrease in 2020, real GDP is forecast to increase by 5% in 2021 and 3.6% in 2022. The nominal GDP level in 2022 is forecast to be 18% above its 2019 level.

A number of relevant developments can be summarised as follows:

- **External vulnerabilities** remain contained, as the current account recorded a surplus of 7.3% of GDP in 2020. The visibly higher surplus is supported by favourable developments of export of goods and services, and is forecast to remain sizeable, even if somewhat lower, going forward. The NIIP, albeit negative, is improving quickly. It mostly consists of the accumulated stock of foreign direct investment, and a sizeable part of the FDI inflows comes from reinvested earnings, reducing associated risks.

Graph A15: Decomposition of unit labour cost



Source: Commission services

- **Unit labour costs** continue to grow rapidly. Pressures in the labour market and increases in wages in the public sector, in part reflecting pandemic management needs, affect labour compensation dynamics. In 2020 and in the first half of 2021, growth of wages stayed elevated, exceeding 10%. The labour share is already relatively high compared to the past, and labour compensation in the public sector is set to slow down following the surge during the pandemic, therefore the current pace of wage growth is not expected to be sustained. Unit labour costs are forecast to grow visibly, but at a slightly lower rate than in recent years.

- The real estate market is witnessing an acceleration in **house prices**. However, valuation gap metrics do not show signs of potential overvaluation. House price growth reached 6.4% in 2020 and accelerated in the first half of 2021. This is partially due to built-up supply side constraints that have started easing slowly. House prices are expected to lose momentum in the coming years, partly due to the projected slowdown in labour income growth. While mortgage credit has been growing dynamically, the household indebtedness is still rather low. The **banking sector** is well capitalised, profitable and NLPs are very low.

- Pressures in the **labour market** are starting to re-emerge. The unemployment rate increased to 8.5% in 2020, but is expected to gradually decrease going forward. Youth unemployment increased in 2020, but is forecast to start declining in 2021. In many economic sectors, labour shortages, which were mounting before the pandemic crisis, are exerting upward pressure on labour costs.

Lithuania entered the COVID-19 crisis with no identified macroeconomic imbalances, although with accumulating pressures in the labour market. Recently shortages in the labour market started to re-emerge, thus exerting upward pressure on labour costs, although unit labour cost growth is forecast to diminish somewhat. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

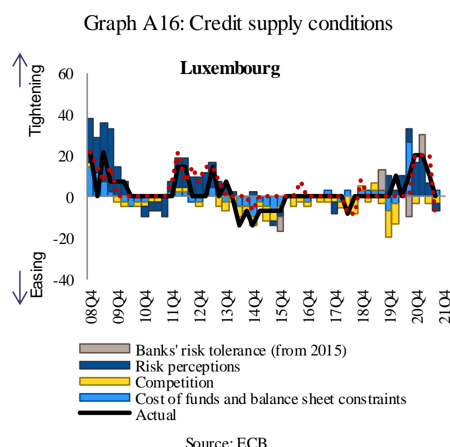
4.16. LUXEMBOURG

In the previous round of the MIP, no macroeconomic imbalances were identified for Luxembourg. In the updated scoreboard including figures until 2020, unit labour cost (ULC) growth, house price growth, private sector debt level and credit growth, as well as youth unemployment indicators are above their indicative thresholds.

Real GDP contracted relatively mildly in 2020, by 1.8%, as a result of the COVID-19 crisis, and reached its pre-crisis level again in the first quarter of 2021. Real growth is forecast at 5.8% in 2021 and 3.7% in 2022, leaving the nominal GDP level in 2022 17.6% higher than in 2019.

A number of relevant developments can be summarised as follows:

Graph A16: Credit supply conditions



Source: ECB

- **External sustainability** risks remain limited. The current account and the net international investment position are markedly positive.
- **Unit labour costs** increased markedly in 2020, partly reflecting temporary labour hoarding during the COVID-19 crisis. Unemployment and the youth unemployment rate increased in 2020 due to the crisis.
- The **private sector debt**-to-GDP ratio is very high at around 317% in 2020, despite some recent decline starting from the second half of 2020, and is mainly driven by **corporate debt.** Cross-border lending activities by intra-group corporates operating in Luxembourg's global financial centre account for 80% of corporate debt, which reduces risks.
- **Household debt** increased further in 2020 to about 69% of GDP, which is below the reference benchmarks, although substantially higher if compared to disposable income (170%). Mortgage credit accelerated further, in a context of very fast house price growth. This has prompted the national systemic risk board to activate macro-prudential (loan-to-value) limits and to increase the countercyclical capital buffer as from January 2021.
- **House prices** have increased at double-digit rates since the pandemic outbreak, with clear indications of potential overvaluation. Price rises are forecast to moderate though, on the back of the adopted measures being implemented. They include reforms of land use and property taxation to help address the structural housing under-supply. Investments in residential construction are also stepped up, aiming at improving the public supply of affordable housing.
- **The banking sector** is well capitalised and liquid, although profitability dropped in 2020. The ratio of non-performing loans has remained very low, also due to timely and appropriate policy responses, including moratoria and short-term employment schemes. A persistence of dynamic mortgage growth, amid already high household indebtedness, represents a risk for the banking sector.

Luxembourg entered the COVID-19 crisis with no identified macroeconomic imbalances, although with some risks related to increasing housing prices and household debt. These risks have increased further. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

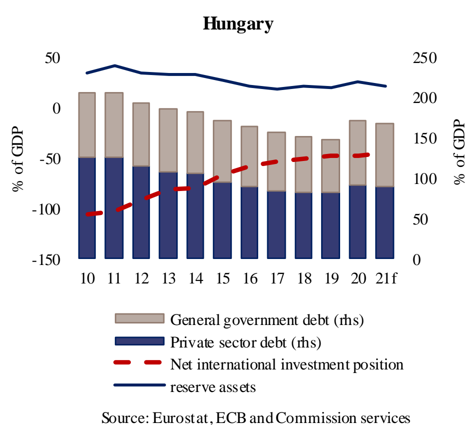
4.17. HUNGARY

In the previous round of the MIP, no macroeconomic imbalances were identified for Hungary. In the updated scoreboard including figures until 2020, the net international investment position (NIIP), unit labour cost (ULC) growth, general government debt, financial sector liabilities and youth unemployment indicators are above their indicative thresholds.

After a 4.7% decrease in 2020, real GDP is forecast to increase by 7.4% in 2021 and 5.4% in 2022. The nominal GDP level in 2022 is forecast to be 25.1% above its 2019 level.

A number of relevant developments can be summarised as follows:

Graph A17: NIIP, private debt and government debt



Source: Eurostat, ECB and Commission services

- **On the external side** vulnerabilities remain, although the large negative NIIP consists mostly of foreign direct investment stocks. The NIIP improved gradually until 2020 and is expected to keep increasing going forward. The current account turned to -1.5% of GDP in 2020 and is expected to remain overall stable in 2021 and 2022.
- **Marked increases of nominal unit labour costs** have so far been partly offset by currency depreciations. Wages are set to accelerate over 2021 and 2022, impacted also by a minimum wage hike and public sector wage increases, reverting to their pre-pandemic trend of strong growth; despite a recovery in productivity, unit labour costs are forecast to increase markedly. Like other countries in the region, Hungary continued to gain export market shares, which benefited from recent inward FDI projects. Official reserves recovered somewhat since early 2020.
- **Private sector indebtedness** rose in 2020, owing to preferential loan schemes and a debt moratorium introduced during the COVID-19 pandemic. The household debt-to-GDP ratio remains among the lowest in the EU. Nearly two fifths of the domestic loans of non-financial corporations are in foreign currency. The crisis brought a temporary deterioration on the **labour market**. The unemployment rate stood at 4.3% in 2020, but is forecast to start falling in 2021.
- The growth of real **house prices** slowed to 1.9% in 2020 (5% in nominal terms), after marked dynamism in the past half decade. Nominal house price growth accelerated visibly in the first half of 2021, to 11.9% in the second quarter. House prices show signs of potential overvaluation in some areas, posing some affordability challenges. Residential construction has been expanding on the back of various policy initiatives.
- **The general government debt** increased by 15 pps in 2020, to 80.1% of GDP, mainly because of additional borrowing due to the COVID-19 crisis and the revaluation of the foreign currency denominated debt. It is forecast to decrease to slightly above 77% of GDP by 2022 even though discretionary spending remains strong on the back of windfall revenues. Gross financing needs are high, but are projected to decrease due to the increasing average maturity. The Central Bank maintains a generous asset purchase programme absorbing some two-thirds of the government issued bonds. The **banking sector** remains overall sound but public sector feedback loops are of relevance with holdings of government debt accounting for almost one fifth of bank assets. Rising liabilities of the financial sector are partly explained by liquidity-boosting monetary policy measures to support the economy in 2020. The withdrawal of debt moratorium schemes may pose challenges for banking sector, whose tier 1 capital ratio is lower than the EU average.

Hungary entered the COVID-19 crisis with no identified macroeconomic imbalances, although with risks related to cost pressures, government debt structure, and the housing market. With the COVID-19 crisis, risks have remained. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.18. MALTA

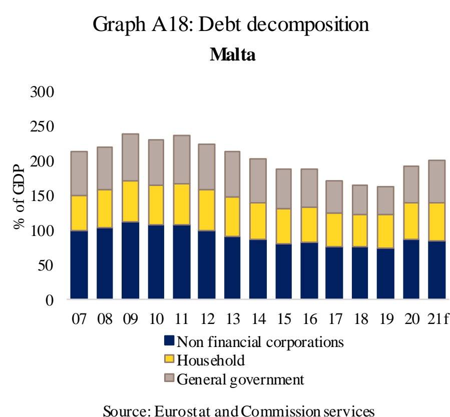
In the previous round of the MIP, no macroeconomic imbalances were identified for Malta. In the updated scoreboard including figures until 2020 two indicators are above their indicative thresholds, namely the private debt and unit labour cost (ULC) growth.

After the decline of 8.3% in 2020, real GDP is forecast to grow by 5% in 2021 and 6.2% in 2022 on the back of a strong recovery from the COVID-19 crisis, leaving nominal GDP in 2022 7.3% above its 2019 level.

A number of relevant developments can be summarised as follows:

- The **net international investment position** (NIIP) is strongly positive, reflecting the Malta's position as an international financial centre. After recording strong positive surpluses for three years until 2019, Malta's current account turned into a deficit of -2.9% in 2020, mainly due to a decline in tourism. It is expected to remain in moderate deficit over the forecasting horizon. Unit labour costs grew markedly in 2020 amid a sharp fall in productivity as policy measures supported employment, but are set to remain broadly unchanged in 2021 and slightly decline in 2022.

Graph A18: Debt decomposition



Source: Eurostat and Commission services

- The **private debt-**to-GDP ratio increased in 2020, to about 139% and thereby mildly exceeded the scoreboard threshold. The ratio is expected to remain around the same level in 2021. Corporate debt increased in 2020 from an already high level but is forecast to start declining slightly in 2021. While steps had been taken to address some anti-money laundering framework issues, Malta has been added to the list of jurisdictions under increased monitoring by the Financial Action Task Force (an inter-governmental body against money laundering). Still, the consequences of this decision are expected to remain limited if the identified shortcomings are swiftly addressed as Malta is committed to do. Household debt increased strongly in 2020 and is expected to remain broadly unchanged in 2021, at just over 100% of household gross disposable income. Household debt mainly consists of mortgages. **House prices** have grown in a sustained way in recent years, with some indications of potential overvaluation although their growth was lower in 2020. Data for the first half of 2021 suggest the growth is picking up again.

- **Government debt** has increased by 13 pps in 2020, to 53.4% of GDP due to the COVID-19 crisis, reflecting the depth of the recession and in particular the government support measures. It is expected to continue increasing in 2021 and 2022 and to fall back to just above 60% by 2031.

- The **banking sector** is well capitalised with a strong liquidity position. The provisioning levels increased and the coverage ratio improved but profitability plummeted in 2020. At 3.6%, the non-performing loans ratio remained moderate in 2020.It will be important going forward to monitor closely the effect of the phasing out of public support measures, such as the loan moratoria and the guarantee schemes. There is an ongoing review of the insolvency framework. Exposure of banks to the real estate sector is substantial.

- The **unemployment rate** remains low. It slightly increased to 4.4% in 2020, reflecting the effects of the COVID-19 crisis. However, as recovery takes hold, it is expected to start declining in 2021 and decrease to almost pre-crisis level in 2022.

Malta entered the COVID-19 crisis with no identified macroeconomic imbalances although relatively dynamic house price growth involved limited risks, also in relation to banks' exposure to real estate. With the COVID-19 crisis, house price pressures moderated somewhat, but still require monitoring. Private and government debt increased. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

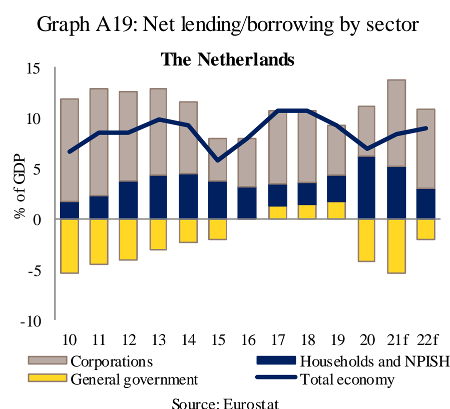
4.19. THE NETHERLANDS

In June 2021, the Commission concluded that the Netherlands was experiencing macroeconomic imbalances, in particular involving the high stock of private debt and the large current account surplus, which have cross-border relevance. In the updated scoreboard including figures until 2020, a number of indicators are above their indicative thresholds, namely the three-year average of the current account balance, nominal unit labour costs, private sector debt and house price growth.

After a 3.8% decrease in 2020, real GDP is forecast to increase by 4% in 2021 and 3.3% in 2022. The nominal GDP level in 2022 is forecast to be 10.2% above its 2019 level.

A number of relevant developments can be summarised as follows:

Graph A19: Net lending/borrowing by sector



Source: Eurostat

- **The current account surplus** decreased to 7% of GDP in 2020 but the three-year average of 9.1% remains well above the scoreboard threshold. The decline in 2020 was a result of a decrease in income account balances, mainly in investment income. The trade balance remained stable in 2020 though with lower underlying trade volumes. From a savings perspective, the surplus in the household and corporate sectors widened but this was more than offset by the government sector, which moved sharply into net borrowing territory due to the implementation of crisis-related fiscal support measures. The overall savings rate in the Netherlands remains high compared to fundamentals and other EU countries. For 2021 and 2022, the savings surplus is expected to increase moderately, with the government deficit forecast to narrow.
- **Private indebtedness** continued to increase in 2020 to almost 234% of GDP and remains significantly above the scoreboard threshold. The high level of **corporate debt**, which is mainly driven by the intra-group debt of multinationals, remained roughly stable in 2020. The **household debt ratio** rose to over 100% of GDP, mostly due to the drop in GDP, but is expected to decrease in 2021 as economic activity recovers from the COVID-19 crisis.
- **Real house prices** increased by 6% in 2020, with some indications of potential overvaluation. High house prices are driven by a number of long-term factors on both the demand (low interest rates in combination with mortgage interest deductibility, underdeveloped private rental market) and the supply side (housing construction falling short of demographic requirements). House price growth is expected to continue and stay above the threshold in 2021.

The Netherlands entered the COVID-19 crisis with a long-standing large domestic savings surplus accompanied by high private debt levels. Having somewhat decreased during the COVID-19 crisis, the savings surplus is expected to increase again going forward. Private sector debt has remained high. Overall, the Commission finds it opportune, also taking into account the identification of imbalances in June, to examine further the persistence of imbalances or their unwinding.

4.20. AUSTRIA

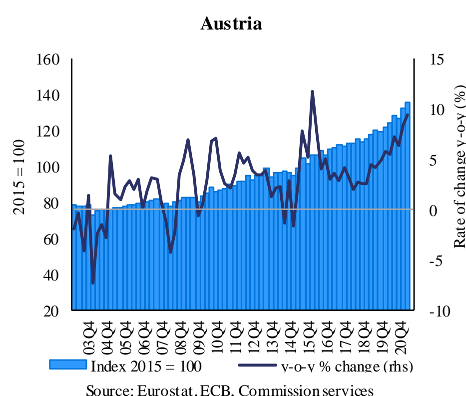
No macroeconomic imbalances were identified in Austria in the previous round of the MIP. In the updated scoreboard, which includes figures until 2020, government debt, house price growth and unit labour cost (ULC) growth indicators are above their indicative thresholds.

After a sharp contraction of economic activity in 2020 -6.7%, real GDP is forecast to bounce back by 4.4% in 2021. With the economic recovery under way, real GDP is expected to grow by 4.9% in 2022, with nominal GDP 8.8% above its 2019 level.

A number of relevant developments can be summarised as follows:

- **External vulnerabilities and competitiveness** concerns remain limited. The current account surplus declined to 1.9% of GDP in 2020 and the current account is expected to be broadly balanced going forward. The net international investment position remains positive at a moderate level. The temporary increase in unit labour cost growth in 2020 reflects temporarily lower productivity amid labour hoarding in the context of the COVID-19 crisis.

Graph A20: Real house price index



Source: Eurostat, ECB, Commission services

- **Private indebtedness** rose to approximately 131% of GDP in 2020, mainly due to both the COVID-19-induced decline in GDP and some net credit flows, especially to corporates. This is projected to be partly reversed in 2021, reflecting the economic recovery.
- **Government debt** departed from its downward trajectory and increased by 13 pps. in 2020, to 83.2% of GDP, as a direct result of automatic stabilisers and the significant fiscal response taken. The government debt-to-GDP ratio is forecast to start declining in 2021.
- Risks associated with the **banking sector** seem to be limited. Banks have little net exposure to neighbouring countries, improved capitalization and lowered leverage. The non-performing loans ratio dropped continuously since 2014, to 2.0% in 2020.
- **Real house prices** accelerated in 2020, to 6.2%, with indications of potential overvaluation. The growth in house prices increased further in the first two quarters of 2021. At the same time, credit growth accelerated in 2021 and household debt levels are broadly in line with their long-standing level.
- In the **labour market,** short-time work schemes helped to mitigate the effect of the economic downturn on unemployment, leading instead to a strong drop in hours worked. The unemployment rate increased moderately, to 5.4% in 2020, but is forecast to decline from 2021 onwards.

Austria weathered the COVID-19 crisis with no identified macroeconomic imbalances. With the COVID-19 crisis, government and private debt have increased and house prices are on the rise, although part of these developments are expected to be partly reversed going forward. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.21. POLAND

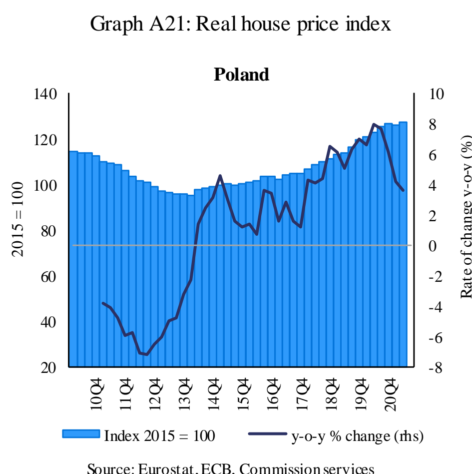
In the previous round of the MIP, no macroeconomic imbalances were identified in Poland. In the updated scoreboard including figures until 2020, the net international investment position (NIIP), unit labour cost (ULC) growth and house price growth indicators are above their indicative thresholds.

After a 2.5% decrease in 2020, real GDP is forecast to increase by 4.9% in 2021 and 5.2% in 2022. The nominal GDP level in 2022 is forecast to be 23.6% above its 2019 level.

A number of relevant developments can be summarised as follows:

- **External vulnerabilities** remain contained, as the NIIP, while negative, improved gradually until 2020. In addition, it consists mainly of the accumulated stock of foreign direct investment and a sizeable part of the FDI inflows comes from reinvested earnings. The NIIP is forecast to continue improving throughout 2021 and 2022. The current account turned more positive in 2020 and is expected to slightly decrease in 2021.
- **Private sector indebtedness** remains low, as households and non-financial companies in Poland are still among the least indebted in the EU. The private sector debt-to-GDP ratio increased in 2020, but is projected to decrease in 2021.

Graph A21: Real house price index



Source: Eurostat, ECB, Commission services

- **House price** growth reached 7.1% in 2020, as low interest rates and increased savings from the pandemic led to a spike in demand for houses. Nevertheless, mortgage growth remains contained so far. As the recovery in the construction sector gathers pace, increasing the supply of houses, house price growth is expected to ease in 2021.
- The **banking sector** remained overall well capitalised and in good condition, despite the pandemic. The non-performing loans ratio dropped in 2020 but is comparatively high and may increase going forward as a result of the COVID-19 crisis. **Government debt** increased to 57.4% of GDP in 2020, compared to 45.6% in 2019, mainly due to additional borrowing in light of the COVID-19 crisis. It is forecast to start falling in 2021.
- Despite the COVID-19 crisis, **labour market** conditions continued to improve. The unemployment rate dropped slightly in 2020, but it is expected to marginally increase to 3.3% in 2021 driven by the phase-out of government support measures. Emerging labour shortages have been putting upward pressure on **unit labour costs**, which increased by 6.3% in 2020. These shortages are expected to ease as migration inflows return and pent-up demand gradually fades. Compensation growth is forecast to be strong though, with a marked productivity upswing expected to mitigate unit labour cost growth.

Poland entered the COVID-19 crisis with no identified macroeconomic imbalances, although with a negative net international investment position involving limited risks. With the COVID-19 crisis, government debt has increased and house price growth has accelerated, but the associated risks appear contained. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.22. PORTUGAL

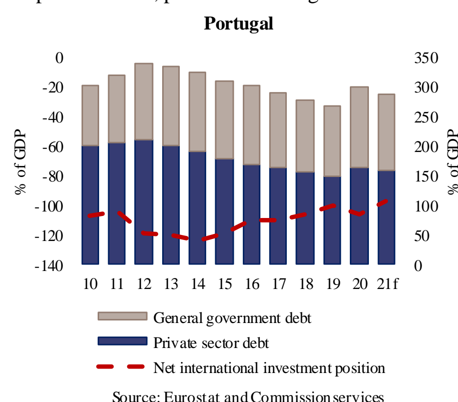
In June 2021, the Commission concluded that Portugal was experiencing macroeconomic imbalances, relating to large stocks of net external liabilities, private and government debt, while non-performing loans remained high, against a backdrop of low productivity growth. In the updated scoreboard including figures until 2020, a number of indicators are above their indicative thresholds, namely the net international investment position (NIIP), private and government debt, house price growth, unit labour cost (ULC) growth and the activity rate. ([44])

After contracting by 8.4% in 2020 as a result of the COVID-19 pandemic, real GDP is forecast to increase by 4.5% in 2021 and 5.3% in 2022. Nominal GDP in 2022 is forecast to be around 5.7% above its 2019 level.

A number of relevant developments can be summarised as follows:

- **External sustainability** remains an issue due to a large stock of net external liabilities, amid some deterioration in the current account balance during the COVID-19 crisis. Nevertheless, despite the country's large exposure to cross-border tourism, the NIIP-to-GDP ratio has recovered to pre-pandemic levels as of mid-2021. It is set to gradually improve further over the forecast period. After years of moderate growth, nominal **unit labour costs** have increased strongly in 2020 and moved above the indicative threshold but are expected to recede somewhat going forward.

Graph A22: NIIP, private debt and government debt



Source: Eurostat and Commission services

- **Private sector indebtedness** has interrupted its downward path during the COVID-19 shock in 2020, mainly due to the economic contraction, which pushed the ratio of private debt up by 14 pps. close to 164% of GDP. Going forward, private indebtedness is set to return to a downward path. Helped by debt moratoria, the non-performing loans (NPLs) ratio continued to decrease during the pandemic, to 4.9% in 2020. It will be important going forward to monitor closely the effect of the phasing out of public support measures, such as the loan moratoria and the guarantee schemes. Moreover, the capital ratio of the **banking sector** and its profitability are low.

- **Government debt** increased by 19 pps. in 2020, to an all-time high of 135.2% of GDP, due to a sudden primary deficit and an unfavourable snowball effect in the context of the COVID-19 crisis. The government debt-to-GDP ratio is set to resume its downward path in 2021. While mitigating factors are at play linked to its profile and composition, as well as the substantial cash buffer, the government debt-to-GDP ratio is expected to remain above its pre-pandemic level for some years. Risks associated to financial and public sector feedback loops remain and may be amplified by increasing vulnerabilities in the corporate sector related to the pandemic.

- **Real growth in house prices** exceeded the indicative threshold for five years in a row until 2020. House prices show signs of potential overvaluation. However, the house price growth slowed down in 2021, helped by increased construction volumes and moderation in demand in some market segments.

- **The activity rate** declined in 2020. This coincides with a slight increase in the unemployment rate. Both the activity rate and unemployment rate are expected to start improving again this year.

Portugal entered the COVID-19 crisis with vulnerabilities linked to large stocks of external, private and government debt in a context of low productivity growth. With the COVID-19 crisis, debt ratios have increased further. Overall, the Commission finds it opportune, also taking into account the identification of imbalances in June, to examine further the persistence of imbalances or their unwinding.

([44]) The Post-Programme Surveillance (PPS) report from autumn 2021 for Portugal also discusses some of the vulnerabilities highlighted in the AMR.

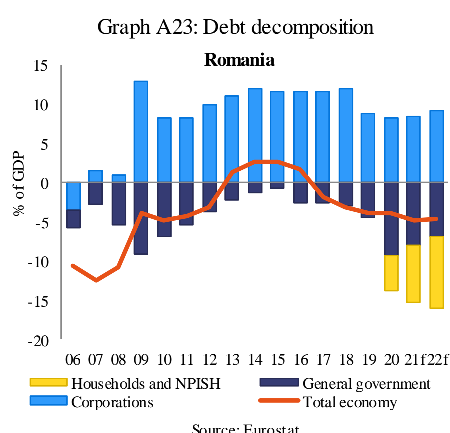
4.23. ROMANIA

In June 2021, the Commission concluded that Romania was experiencing macroeconomic imbalances, in particular a persistent sizeable current account deficit in a context of large government deficits, while previous overheating pressures were receding. In the updated scoreboard including figures until 2020, a number of indicators are above their indicative thresholds, namely the current account balance, the net international investment position (NIIP) and unit labour cost (ULC) growth.

After a decrease of 3.9% in 2020, due to the COVID-19 crisis, real GDP is forecast to pick up in 2021, increasing by 7% in 2021 and 5.1% in 2022. Nominal GDP in 2022 is forecast to exceed its 2019 level by 21.4%.

A number of relevant developments can be summarised as follows.

Graph A23: Debt decomposition



Source: Eurostat

- As to **external sustainability,** the current account deficit at 5% of GDP in 2020 is forecast to widen in 2021 to around 6% of GDP, largely due to a strongly negative trade balance The NIIP is set to remain stable at around -48% of GDP in 2021 and 2022. The NIIP excluding non-defaultable instruments (NENDI) is slightly negative.
- **Competitiveness** was further negatively affected by a marked increase in nominal unit labour costs in 2020, partially due to the sharp fall in output and the subsequent fall in productivity amid labour hoarding during the COVID-19 crisis. For 2021 and 2022, however, marked recuperations in productivity are expected to limit unit labour cost growth despite comparatively strong growth of compensation per employee.
- **House prices** increased slightly in 2020 but house price growth is forecast to accelerate in 2021.
- **General government debt**, while still clearly below the 60% of GDP threshold, has increased by 12 pps in 2020, due to COVID-19 crisis measures and continued fiscal deficits. The government debt-to-GDP ratio is estimated to increase to 49.3% of GDP for 2021 and expected to continue growing in 2022.
- The non-performing loans ratio of the **banking sector** was broadly stable over 2020 and early 2021 at around 4% of total loans. Private sector debt is very low.
- The **unemployment rate** increased to 5% in 2020. It is forecast to remain at the same level in 2021, but start declining afterwards. Also the youth unemployment rate increased in 2020 and is forecast to increase further in 2021.

Romania entered the COVID-19 crisis with vulnerabilities linked to a widening current account deficit, a deteriorating external position and significant cost competitiveness losses. With the COVID-19 crisis, government debt has increased, albeit from low levels. Overall, the Commission finds it opportune, also taking into account the identification of imbalances in June, to examine further the persistence of imbalances or their unwinding.

4.24. SLOVENIA

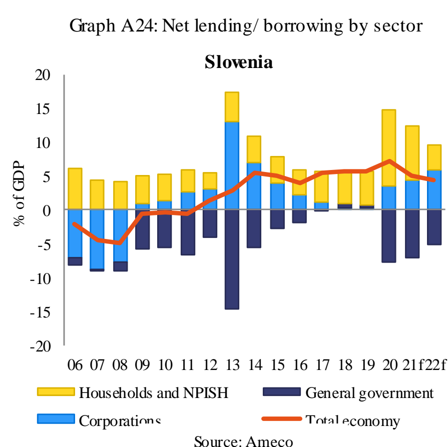
In the previous round of the MIP, no macroeconomic imbalances were identified for Slovenia. In the updated scoreboard including figures until 2020, the current account surplus, unit labour cost growth, the general government gross debt and the youth unemployment growth indicators are above their indicative thresholds.

After a 4.2% decrease in 2020, real GDP is forecast to increase by 6.4% in 2021 and 4.2% in 2022. The nominal GDP level in 2022 is forecast to be 11.1% above its 2019 level.

A number of relevant developments can be summarised as follows:

- **The large current account surplus widened further** from 6% to 7.4% of GDP in 2020, pushing the 3-years average above the upper indicative threshold. The current account surplus is forecast to narrow somewhat in 2021 and 2022. The negative NIIP has been gradually but steadily improving since 2012, reaching -15.2% of GDP in 2020 and is expected to move close to balance by 2022. Slovenia's export market share has grown visibly over the latest number of years.

Graph A24: Net lending/ borrowing by sector



Source: Ameco

- **Private sector indebtedness** increased only slightly in 2020 to 69.7% of GDP and remains below the prudential and fundamental benchmarks. This increase mainly reflects the drop in GDP as the credit flow was negative in 2020. **House prices** grew at 5.2%, in line with recent trends.

- **The banking sector** remains well capitalised, its profitability declined only slightly, and the non-performing loans ratio continued to ease in 2020.

- **Government debt** increased to 79.8% of GDP in 2020, compared to 65.6% in 2019, due to the additional borrowing in light of the COVID-19 crisis the sharp drop in GDP in 2020 to a lesser extent. General government debt is forecast to decline in 2021 and 2022.

- **Labour market** conditions deteriorated somewhat in context of the COVID-19 pandemic. The unemployment rate increased slightly to 5% in 2020, compared to 4.5% in 2019. The youth unemployment rate, which had declined strongly in previous years, increased particularly sharply, from 8.1% in 2019 to 14.2% in 2020. However, 2021 data point towards an improvement in labour market conditions and fall in unemployment rates. **Unit labour cost** grew by 7.4% in 2020, on the back of labour hoarding associated with the COVID-19 crisis. Improved productivity over the recovery is forecast to lead to a decline in unit labour costs in 2021 and 2022.

Slovenia entered the COVID-19 crisis with no identified macroeconomic imbalances, although with a high government debt, involving limited risks. With the COVID-19 crisis, government debt has increased and the large current account surplus widened further. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

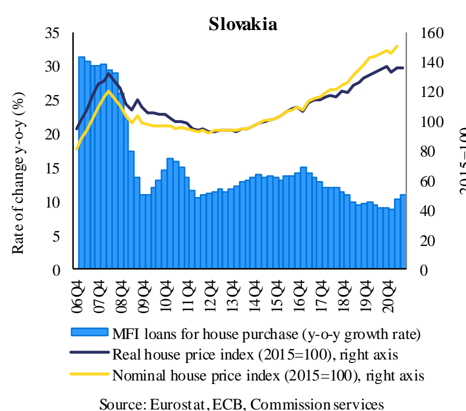
4.25. SLOVAKIA

In the previous round of the MIP, no macroeconomic imbalances were identified in Slovakia. In the updated scoreboard including figures until 2020, the net international investment position (NIIP), the real effective exchange rate (REER), unit labour cost (ULC) growth and house price growth indicators are above their indicative thresholds.

After a 4.4% decrease in 2020, real GDP is forecast to increase by 3.8% in 2021 and 5.3% in 2022, bringing nominal GDP in 2022 13.6% above its 2019 level.

A number of relevant developments can be summarised as follows:

Graph A25: House price and mortgage growth



Source: Eurostat, ECB, Commission services

- **External vulnerabilities** remain. At around -66% of GDP, the NIIP was still significantly above the threshold in 2020. Most of it is due to non-defaultable liabilities related to past investment flows, which may be more stable and thereby less of a risk. The NIIP is forecast to gradually improve in 2021 and 2022 on the back of positive net lending flows.
- **Unit labour cost** growth was high before the pandemic and accelerated further in 2020. However, recent developments mostly reflect labour hoarding in the context of the COVID-19 crisis. Going forward, ULC growth is expected to markedly slow down due to a reversal of the labour hoarding effect on productivity, while the high growth of compensation per employee is set to continue weighing on it. The HICP-based REER was slightly above the threshold in 2020, but export market shares have not been adversely affected. High export concentration in a few sectors and integration in global value chains remain risk factors though.
- **Private sector indebtedness,** and in particular household mortgage debt, has been increasing for several years, but its growth rate had decreased. Household debt increased to around 47% of GDP in 2020. It remains slightly below prudential levels but in excess of the level implied by fundamentals.
- Real **house prices** accelerated to 7.2% in 2020, thereby possibly contributing to household indebtedness. House prices show signs of potential overvaluation. House price growth is expected to decrease in 2021.
- Due to supportive fiscal policy, **government debt** increased by 12 pps, to 59.7% of GDP in 2020. It is expected to marginally increase in 2021 but to revert to around 60% of GDP afterwards, supported by robust growth, low interest rates and declining primary budget deficits.
- The **banking sector** is sound with robust capital buffers. The non-performing loans ratio continued to decrease in 2020 and is below the EU average, but it could increase as crisis measures are withdrawn. Housing market exposure of bank balance sheets has increased.

Slovakia entered the COVID-19 crisis with no identified macroeconomic imbalances, although external sustainability, domestic price pressures and dependence on the automotive industry involved some risks. With the COVID-19 crisis, some risks have increased. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.26. FINLAND

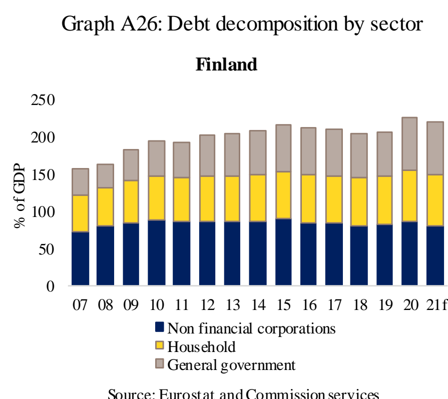
In the previous round of the MIP, no macroeconomic imbalances were identified in Finland. In the updated scoreboard including figures until 2020 two indicators, private sector debt and general government gross debt, are above their indicative thresholds.

After a 2.9% decrease in 2020, real GDP is forecast to increase by 3.4% in 2021 and 2.8% in 2022. The nominal GDP level in 2022 is forecast to be 8.7% above its 2019 level.

A number of relevant developments can be summarised as follows:

- **On the external side,** the current account balance turned positive and the trade surplus widened marginally in 2020 as export market share increased. Going forward, the current account is expected to record a small surplus. The net international investment position decreased to -5.3% of GDP in 2020. Unit labour costs rose marginally, due to the drop in productivity induced by the crisis.

Graph A26: Debt decomposition by sector



Source: Eurostat and Commission services

- **Private sector indebtedness** continued to increase, with the private debt-to-GDP ratio increasing in part due to a drop in GDP. This is projected to be partly reversed in 2021 with the firming up of the economic recovery. However, favourable credit conditions including low interest rates and rapid growth in residential building construction are expected to sustain the increase in the private debt-to-GDP ratio even if the effect of the COVID-19 recession fades.
- **Government debt** increased to 69.5% of GDP in 2020, compared to 59.5% in 2019, due to the government's fiscal response to the crisis and, to a lesser extent, the drop in GDP in 2020. It is forecast to stabilise at 71% from 2021 onwards.
- The **banking sector** remains well capitalised and the non-performing loans ratio is low and has remained broadly unchanged and is not expected to rise significantly. There was no visible impact of COVID-19 crisis on debt servicing nor on number of company bankruptcies. Risks to financial stability remain limited, despite significant cross-border exposures, especially with other Nordic countries.
- **Labour market** conditions deteriorated marginally during the crisis aided by government support measures that limited the increase in the unemployment rate to 1.1 percentage points, bringing it to 7.8% in 2020. The unemployment rate is forecast to start gradually declining from 2021 onwards, as the economy recovers, but it is not expected to drop to its pre-pandemic level before 2023.

Finland entered the COVID-19 crisis with no identified macroeconomic imbalances, although with vulnerabilities linked to the private sector debt. With the COVID-19 crisis, the private debt ratio has increased, but risks remain limited. Overall, the Commission does not consider it necessary at this stage to carry out further in-depth analysis in the context of the MIP.

4.27. SWEDEN

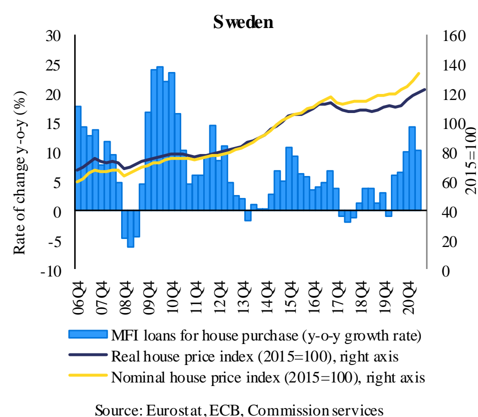
In June 2021, the Commission concluded that Sweden was experiencing macroeconomic imbalances, relating to risks of overvalued house prices coupled with a high and rising household debt. In the updated scoreboard including figures until 2020, two indicators are above their indicative thresholds, namely private debt and youth unemployment.

After declining by 2.8% in 2020, real GDP is forecast to increase by 3.9% in 2021 and by 3.5% in 2022. The nominal GDP level in 2022 is forecast to be 9.9% above the 2019 one.

A number of relevant developments can be summarised as follows:

- The **current account surplus** increased to 5.7% of GDP in 2020 while the NIIP decreased slightly, close to 16% of GDP. In 2021 and 2022, the current account surplus is expected to remain at around 5% of GDP. Export market shares continued increasing in 2020. The real effective exchange rate appreciated by 3% in 2020 after three years of depreciation.

Graph A27: House price and mortgage growth



- **Private sector debt** reached a new high in 2020 at around 216% of GDP, continuing its upward trend. Both household and corporate debt are above prudential and fundamental benchmarks. For 2021, a levelling off at high levels is expected for private debt while net financial assets are set to become more negative. **Household debt** grew to about 95% of GDP in 2020. Mortgage loans to households continued to grow in the first half of 2021. **House prices** accelerated over 2020 and particularly strongly in the second quarter of 2021. House prices remain overall very high with indications of potential overvaluation.

- The **government debt** level remains low despite significant support measures during the pandemic. In 2020, government debt increased to 39.7% of GDP. In 2021, it is expected to start declining.

- The **banking sector** remains healthy. During the pandemic, the tier-1 capital ratio and the non-performing loans incidence improved from already sound scores. The FSA partly reversed the loosening of macro-prudential measures during 2021 and reinstated the amortization requirement as of 1 September 2021. Regardless of the overall healthy financial position, the leverage ratio of Swedish banks is among the highest in the EU.

- Notwithstanding policy support measures, **unemployment** increased to 8.3% in 2020. Youth unemployment jumped to approximately 24% in 2020. The unemployment rate is forecast to start falling from 2021 onwards.

Sweden entered the COVID-19 crisis with vulnerabilities linked to risks of overvalued house price levels coupled with high and continuously rising household debt. With the COVID-19 crisis, private debt ratios, house prices and the unemployment rate have increased. Overall, the Commission finds it appropriate, also considering the identification of imbalances last June, to examine further the persistence of imbalances or their unwinding.

ANNEX 1: FORECASTS AND NOWCASTS OF THE HEADLINE SCOREBOARD INDICATORS

To enhance the forward-looking elements in the scoreboard reading, the AMR analysis builds also, whenever possible, on forecasts and projections for 2021 and beyond and on 'nowcasts' for the current year. Whenever available, such figures are based on the Commission autumn 2021 forecast. Otherwise, figures mostly display nowcasts based on proxy indicators, prepared by Commission services for this AMR.

The table below summarises the assumptions used for the forecasts and nowcasts figures of headline scoreboard indicators. The GDP figures used as denominators in some ratios stem from the Commission autumn 2021 forecast.

In case of multi-annual rates of change (e.g., the five-year change of export market shares), only the 2021 and 2022 component is based on forecasts, whereas components related to 2020 or earlier years use the Eurostat data underlying the MIP scoreboard.

Table 1: **Approaches to forecasts and nowcasts for MIP scoreboard headline indicators**

Indicator	Approach	Data sources
Current account balance, % of GDP (3 year average)	Values from Commission autumn 2021 forecast of the current account balance (Balance of Payments concept)	AMECO
Net international investment position (% of GDP)	The Commission autumn 2021 forecasts for total economy net lending/borrowing provides the NIIP change that reflects transactions for 2021-2023, for 2024 and 2025, the current account forecast from the IMF's World Economic Outlook is used assuming the capital account to stay constant. Other effects (e.g. valuation changes) are taken into account until 2021Q2, and assumed to remain nil thereafter.	AMECO, Eurostat
Real effective exchange rate – 42 trading partners, HICP deflator (3 year % change)	Values from the Commission autumn 2021 forecast	AMECO
Export market share – % of world exports (5 year % change)	Figures are based on the Commission autumn 2021 forecast of: i) nominal goods and services (G&S) exports for EU Member States (national accounts concept), and ii) Commission forecast of G&S exports in volumes for the rest of the world, translated to nominal levels by the Commission US import deflator and EUR/USD exchange rate forecasts.	AMECO
Nominal unit labour cost index, 2010=100 (3 year % change)	Values from the Commission autumn 2021 forecast	AMECO
House price index (2015=100), deflated (1 year % change)	The forecast for 2021 includes 2021Q1-Q2 data where available. It assumes 2021Q3-Q4 house price growth to follow the predicted growth rate from the short-term relationship given by a housing valuation model shared with Member States in the context of the EPC LIME working group.	Eurostat, Commission services

Private sector credit flow, consolidated (% of GDP)	The figure for 2021 represents a proxy of credit flows 2020Q4-2021Q3, using consolidated data from ECB quarterly sectoral accounts for 2020Q4-Q2, plus proxies for some credit flow components from 2021Q3. The latter uses ECB BSI MFI loan flows to the private sector to project 2021Q3 bank loan components, and ECB SEC nominal debt security issuance to project 2021Q3 bond issuance.	ECB (QSA, BSI, SEC)
Private sector debt, consolidated (% of GDP)	The figure for 2021 proxies private sector debt for end-2021Q4. It uses consolidated data from ECB quarterly sectoral accounts for 2021Q2. This figure is projected forward to 2021Q3 using bank loan figures (based on ECB BSI) and bond liability data (based on ECB SEC), and assumes 2021Q4 credit to be the same as in 2020Q4 (see above).	ECB (QSA, BSI, SEC)
General government gross debt (% of GDP)	Values from the Commission autumn 2021 forecast	AMECO
Unemployment rate (3 year average)	Values from the Commission autumn 2021 forecast	AMECO
Total financial sector liabilities, non-consolidated (1 year % change)	2021 figure represent 12-month ECB MFI liabilities growth until September 2021.	ECB (BSI)
Activity rate - % of total population aged 15-64 (3 year change in pp)	The 2021 and 2022 rate of changes are based on the Commission autumn 2021 forecast for the change in the entire labour force (all ages) minus the Commission autumn forecast for the population change (15-64 age group).	AMECO
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	The nowcast for 2021 is based on latest data (2021Q1-Q2, assuming a constant rate for rest of the year)	Eurostat (LFS)
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	The nowcast for 2021 is based on latest data (2021 Jan-Sep, assuming a constant rate for rest of the year)	Eurostat (LFS)

ANNEX 2: MIP SCOREBOARD

Table 1. **MIP scoreboard 2020**

	External imbalances and competitiveness					Internal imbalances							Employment indicators[1]		
Year 2020	**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 (2010=100)** (3 year % change)	**House price index (2015=100), 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
BE	0.1	44.4	2.5	10.9	7.5p	3.6	1.1p	192.0p	112.8	5.7	8.8	0.6b	-1.2	-4.0
BG	0.8	-26.3	7.1	16.0	20.4	5.2p	4.2	94.3	24.7	4.8	11.1	0.9	-1.1	1.3
CZ	1.5	-12.5	5.6	10.1	19.2	5.5	2.4	81.9	37.7	2.3	3.4	0.5	-0.4	0.1
DK	8.1	68.8	0.9	11.5	6.2	4.6	4.8	220.9	42.1	5.2	5.7	1.1b	-0.3	-0.8
DE	7.4	61.7	2.4	1.3	11.1p	7.1	6.0p	120.1p	68.7	3.4bp	11.3	1.1bp	-0.5bp	0.6bp
EE	1.0	-21.5	5.3	17.6	17.1	6.9	3.6	104.4	19.0	5.5	17.5	0.5	-0.7	5.8
IE	-5.8	-174.0	-1.2	50.0	-6.3	-0.2	-1.8	188.9	58.4	5.5	7.2	-0.8	-1.7	0.9
EL	-3.7	-175.0	0.4	-10.1	6.4p	5.5e	5.4p	125.3p	206.3	17.6	27.4	-0.9	-4.7	-8.6
ES	1.6	-85.5	1.1	-6.8	11.0p	2.2	4.4p	146.4p	120.0	15.0	9.5	-1.7	-2.7	-0.3
FR	-1.0	-30.2	2.7	-6.9	4.6p	4.4	13.0p	173.7p	115.0	8.5	11.6p	-0.5	-1.3	-1.9
HR	1.6	-47.8	0.5	0.1	13.7p	7.3	1.3p	98.0p	87.3	7.5	7.3	0.7	-2.5	-6.3
IT	3.2	2.4	0.6	-2.8	5.5	2.2	4.1	118.9	155.6	9.9	6.8	-1.3	-1.8	-5.3
CY	-6.6	-136.7	0.1	28.5	5.8p	0.7p	-2.6p	260.5p	115.3	7.7	-2.5	1.9	-2.4	-6.5
LV	0.7	-34.7	5.9	18.2	18.4	2.7	-1.8	66.5	43.2	7.3	10.8	1.2	-1.1	-2.1
LT	3.7	-15.8	6.9	39.3	18.3	6.4	0.3	54.7	46.6	7.0	28.5	2.6	-0.2	6.3
LU	4.5	39.9	1.5	20.6	11.1	13.8	44.5	316.8	24.8	6.0	-3.6	2.0	-0.4	7.8
HU	-0.7	-48.1	-4.9	8.2	13.2p	1.9p	7.7p	76.4p	80.1	3.8	55.3	1.6	-0.6	2.1
MT	3.0	60.3	2.1	13.2	19.7	2.2p	9.0	139.1	53.4	3.9	1.9	4.9	-0.9	0.3
NL	9.1	113.9	3.8	7.4	14.0p	6.0p	-1.3p	233.7p	54.3	3.7	3.3p	1.2	-1.0	0.2
AT	1.6	9.3	3.2	5.2	12.2	6.2	4.7	131.2	83.2	4.9	10.6	0.2	-0.5	0.7
PL	0.7	-44.5	1.1	36.9	12.3p	7.1p	1.5	75.9	57.4	3.5	11.7	1.4	-0.9	-4.0
PT	0.0	-106.4	0.0	-0.9	16.2p	7.7	4.4p	163.7p	135.2	6.8	7.2	-0.4	-2.2	-1.3
RO	-4.9	-48.3	3.4	20.6	26.1p	2.3	1.3p	48.5p	47.4	4.4	13.4	1.9	-0.5	-1.0
SI	6.4	-15.2	1.9	20.2	14.9	5.2	-0.9	69.7	79.8	4.9	14.0	0.4	-1.2	3.0
SK	-1.8	-65.7	5.3	8.1	16.4	7.2	3.7	95.3	59.7	6.3	9.9	0.3	-1.9	0.4
FI	-0.4	-5.3	2.3	12.3	6.1	1.3	6.5	155.2	69.5	7.3	7.7	1.6	-0.9	1.3
SE	4.6	16.4	-4.8	4.5	9.4	3.0	11.6	215.7	39.7	7.2b	11.2	0.0	-0.1	6.0

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

1) For the employment indicators, see page 2 of the AMR 2016. 2) House price index e = estimate by NCB for EL. 3) Labour Force Survey indicators, b = due to technical issues with the introduction of the new German system of integrated household surveys, including the LFS, the figures for Germany in 2020 are not direct estimates from LFS micro-data, but based on a larger sample including additional data from other integrated household surveys.

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)

Table 2. **Auxiliary indicators, 2020**

Year 2020	Real GDP (1 year % change)	Gross fixed capital formation (% of GDP)	Gross domestic expenditure on R&D (% of GDP)	Current plus capital account (Net lending-borrowing) (% of GDP)	Net international investment position excluding non-defaultable instruments (% of GDP)	Foreign direct investment in the reporting economy - flows	Foreign direct investment in the reporting economy - stocks	Net trade balance of energy products (% of GDP)	Real effective exchange rate - euro area trading partners (3 year % change)	Export performance against advanced economies (5 year % change)	Terms of trade (5 year % change)	Export market share in volume (1 year % change)	Labour productivity (1 year % change)	Gross non-performing loans of domestic and foreign entities (% of gross loans)	Unit labour cost performance relative to EA (10 year % change)	House price index (2015=100) - nominal (3 year % change)	Residential construction (% of GDP)	Household debt, consolidated (incl. NPISH, % of GDP)	Consolidated banking leverage, domestic and foreign entities (total assets/total equity)
BE	-5.7p	23.9p	na	0.8	37.8	-3.6	174.8	-1.7p	0.4	11.4	0.8p	2.4p	-5.6p	2.1p	0.5	11.5	6.2p	66.4	14.2p
BG	-4.4	19.2	0.9p	1.3	47.1	3.9	84.8	-2.1	3.0	16.6	12.7	-4.2	-2.1	5.9p	39.2	18.2p	2.9	24.7	7.9p
CZ	-5.8	26.2	2.0p	4.8	36.9	2.5	81.5	-1.5	3.7	10.6	2.2	1.0	-4.2	1.9p	10.9	28.6	4.8	34.0	12.1p
DK	-2.1	22.4	3.0p	8.1	30.0	0.4	58.4	-0.4	-2.0	12.0	1.2	0.9	-1.4	1.9p	-8.1	12.3	5.5	111.7	17.4p
DE	-4.6p	21.9p	3.1p	6.8	53.2	2.9	49.8	-1.3p	0.1	1.8	2.9p	-1.4p	-3.8p	1.2p	11.2	21.6	7.0p	57.7	14.4p
EE	-3.0	30.7	1.8p	1.9	42.3	11.4	113.5	-0.5	1.3	18.1	1.4	2.9	-0.3	1.6p	23.4	20.2	5.5	41.8	8.8p
IE	5.9	39.7	1.2p	-6.8	-292.9	8.2	428.5	-0.7	-2.5	50.7	-3.0	17.4	7.5	3.4p	-35.4	13.2	2.1	35.9	8.8p
EL	-9.0p	11.7p	1.5p	-5.0	-155.2	1.8	23.4	-1.8p	-3.2	-9.7	-3.1p	-13.6p	-7.9p	26.4p	-13.7	14.0e	1.1p	59.5	13.8p
ES	-10.8p	20.3p	1.4p	1.2	-52.8	2.6	78.9	-1.3p	-1.2	-6.4	0.9p	-12.2p	-7.0p	2.8p	-11.2	14.8	6.0p	62.5	15.8p
FR	-7.9p	23.0p	2.4p	-1.8	-41.9	0.4	50.3	-1.1p	0.6	-6.4	0.0p	-7.9p	-7.0p	2.2p	-3.6	11.9	6.1p	68.7p	16.2p
HR	-8.1p	22.3p	1.3p	2.1	-0.3	2.1	65.3	-2.0p	-2.0	0.6	1.5p	-14.8p	-7.0p	5.3p	-11.9	24.5	na	38.3	7.6p
IT	-8.9	17.8	1.5p	3.7	1.4	-1.1	30.8	-1.3	-1.9	-2.4	5.9	-6.1	-7.0	4.5p	-7.5	1.2	4.1	45.1	13.9p
CY	-5.2p	20.0p	na	-10.0	-170.4	-0.6	1886.4	-3.3p	-3.0	29.1	-0.8p	2.8p	-4.7p	11.0p	-15.0	5.3p	7.6p	91.0	13.6p
LV	-3.6	24.5	0.7p	4.7	14.5	2.8	60.0	-1.6	1.5	18.8	9.3	5.7	-1.3	4.6p	27.8	23.5	3.0	20.9	10.0p
LT	-0.1	21.1	1.2p	9.1	15.2	8.0	56.2	-2.4	2.1	39.9	2.8	8.3	1.5	2.2p	26.5	23.0	3.2	24.6	15.5p
LU	-1.8	16.8	na	4.0	-4095.3	-214.4	6136.5	-2.0	0.0	21.2	-0.5	9.2	-3.6	0.7p	6.6	35.0	3.7	69.2	14.3p
HU	-4.7p	26.8p	1.6	0.5	-2.4	111.5	327.3	-2.2p	-6.5	8.7	1.4p	2.0p	-3.7p	3.6p	14.4	40.4p	4.1p	20.9	10.8p
MT	-8.3	21.7p	0.7	-2.3	270.2	29.4	1602.5	-5.5	0.7	13.7	2.4	1.6	-10.7	3.6p	20.7	16.1p	3.9p	54.0	10.7p
NL	-3.8p	21.3p	na	6.9	9.2	-16.7	567.0	-0.5p	2.0	7.9	1.8p	3.1p	-3.3p	1.9p	3.0	26.4p	5.3p	103.0p	16.7p
AT	-6.7	25.2	3.2p	1.8	-5.6	-4.1	57.4	-1.4	1.4	5.7	-0.2	-2.9	-5.2	2.0p	5.5	19.3	5.1	53.2	11.9p
PL	-2.5	16.6	1.4p	5.2	-6.2	2.9	48.5	-1.6	-1.0	37.6	3.5	8.0	-2.4p	6.0p	4.9	28.0p	2.0	34.8	10.5p
PT	-8.4p	19.1p	1.6p	0.0	-47.0	2.0	87.2	-1.7p	-1.9	-0.4	2.2p	-10.7p	-6.7p	4.9p	-1.0	31.1	3.4p	69.5	11.4p
RO	-3.9p	24.6p	0.5p	-3.1	-7.2	1.4	46.4	-1.2p	1.0	21.2	5.4p	-1.8p	-2.2p	3.9p	23.5	14.3	2.6p	16.2	9.1p
SI	-4.2	18.9	2.2p	6.9	2.0	0.9	42.9	-2.0	-0.2	20.8	1.4	-0.8	-3.7	3.0p	-0.5	21.4	2.3	27.8	9.3p
SK	-4.4	19.6	0.9	1.3	-14.8	-0.2	70.4	-2.1	3.8	8.6	-2.2	0.6	-2.5	2.5p	10.1	28.4	3.9	47.2	9.7p
FI	-2.9	24.2	2.9	0.9	4.9	-0.8	50.3	-0.9	-1.0	12.8	0.1	1.1	-0.8	1.5p	-5.5	3.9	7.1	69.6	16.0p
SE	-2.8	24.8	3.5p	5.7	-4.5	5.3	92.4	-0.8	-7.4	5.0	-0.8	3.3	-1.5	1.0p	7.4	5.8	5.0	94.7	17.6p

Flags: e: Estimated. p: Provisional.
1) Official transmission deadline for 2020 data on Gross domestic expenditure on R&D is 31 October 2021 while data were extracted on 22 October 2021. 2) House price index e = estimate by NCB for EL.
Source: European Commission, Eurostat and Directorate General for Economic and Financial Affairs (for Real Effective Exchange Rate), European Central Bank (for Consolidated banking leverage and Gross non-performing loans, domestic and foreign entities), and International Monetary Fund data, WEO (for world volume exports of goods and services)

Table 2 (continued): **Auxiliary indicators, 2020**

Year 2020	Employment (1 year % change)	Activity rate - % of total population aged 15-64 (%)	Long-term unemployment rate - % of active population aged 15-74 (%)	Youth unemployment rate - % of active population aged 15-24 (%)	Young people neither in employment nor in education and training - % of total population aged 15-24		People at risk of poverty or social exclusion - % of total population		People at risk of poverty after social transfers - % of total population		Severely materially deprived people - % of total population		People living in households with very low work intensity - % of total population aged 0-59	
					%	3 year change in pp	%	3 year change in pp	%	3 year change in pp	%	3 year change in pp	%	3 year change in pp
BE	0.0p	68.6	2.3	15.3	9.2	-0.1b	18.9b	-1.7b	14.1b	-1.8b	3.9b	-1.3b	11.9b	-2.0b
BG	-2.3	72.2	2.3	14.2	14.4	-0.9	32.1	-6.8	23.8	0.4	19.4	-10.6	8.5	-2.6
CZ	-1.7	76.4	0.6	8.0	6.6	0.3	11.9	-0.3	9.5	0.4	2.4	-1.3	4.4	-1.1
DK	-0.7	79.0	0.9	11.6	7.4	-0.2b	15.9b	-1.3b	12.1b	-0.3b	2.4	-0.7	9.1	-0.9
DE	-0.8p	79.3bp	1.1bp	7.4bp	7.3bp	1.0bp	24.0b	5.0b	18.5b	2.4b	6.6bu	3.2bu	9.5b	0.8b
EE	-2.7	79.3	1.2	17.9	8.9	-0.5	23.3	-0.1	20.7	-0.3	2.8	-1.3	4.7	-1.1
IE	-1.5	71.9	1.3	15.3	12.0	1.1b	na	na	na	na	na	na	na	na
EL	-1.2p	67.4	10.9	35.0	13.2	-2.1	28.9	-5.9	17.7	-2.5	16.5	-4.6	12.8	-2.8
ES	-4.1p	72.2	5.0	38.3	13.9	0.6	26.4	-0.2	21.0	-0.6	7.0	1.9	9.9	-2.9
FR	-0.9p	71.0	2.9	20.2	11.4	0.0	18.2p	1.2p	13.8p	0.6p	4.8p	0.7p	8.8p	0.7p
HR	-1.2p	67.1	2.1	21.1	12.2	-3.2	23.2	-3.2	18.3	-1.7	6.9	-3.4	8.6	-3.6
IT	-2.1	64.1	4.7	29.4	19.0	-1.1	na	na	na	na	na	na	na	na
CY	-0.6p	75.8	2.1	18.2	14.4	-1.7	21.3	-3.9	14.3	-1.4	8.3	-3.2	5.6	-3.8
LV	-2.3	78.2	2.2	14.9	7.1	-3.2	na	na	na	na	na	na	na	na
LT	-1.6	78.5	2.5	19.6	10.8	1.7	24.8	-4.8	20.9	-2.0	7.7	-4.7	7.3	-2.4
LU	1.9	72.2	1.7	23.2	6.6	0.7	20.9b	1.5b	17.4b	1.0b	1.7b	0.5b	7.9b	1.0b
HU	-1.0	72.8	1.1	12.8	11.7	0.7	17.8	-7.8	12.3	-1.1	8.0	-6.5	5.0	-1.6
MT	2.7	77.1	1.1	10.9	9.3	0.7b	19.0	-0.3	16.9	0.2	3.3	0.0	5.4	-1.7
NL	-0.5p	80.9	0.9	9.1	4.5	0.5	16.3p	-0.7p	13.6p	0.4p	2.1p	-0.5p	8.9p	-0.6p
AT	-1.6	76.6	1.3	10.5	8.0	1.5	17.5	-0.6	13.9	-0.5	2.7	-1.0	7.1	-1.2
PL	-0.1p	71.0	0.6	10.8	8.6	-0.9	17.3p	-2.2p	14.8p	-0.2p	2.6p	-3.3p	4.3p	-1.4p
PT	-1.9p	74.3	2.3	22.6	9.1	-0.2	19.8	-3.5	16.2	-2.1	4.6	-2.3	5.1	-2.9
RO	-1.8p	69.2	1.5	17.3	14.8	-0.4	30.4	-5.3	23.4	-0.2	15.2	-4.5	6.3	-0.6
SI	-0.6	74.6	1.9	14.2	7.7	1.2	15.0	-2.1	12.4	-0.9	3.0	-1.6	4.8	-1.4
SK	-1.9	72.4	3.2	19.3	10.7	-1.4	14.8p	-1.5p	11.4p	-1.0p	5.9p	-1.1p	4.3p	-1.1p
FI	-2.1	78.3	1.2	21.4	9.3	-0.1	16.0	0.3	12.2	0.7	2.6	0.5	9.9	-0.8
SE	-1.3	82.5	1.1	23.9	6.5	0.3	17.9	0.2	16.1	0.3	1.8u	0.7u	8.5	-0.3

Flags: b: Break in series. p: Provisional. u: Low reliability.
1) Labour Force Survey indicators, b = due to technical issues with the introduction of the new German system of integrated household surveys, including the LFS, the figures for Germany in 2020 are not direct estimates from LFS micro-data, but based on a larger sample including additional data from other integrated household surveys. 2) Official transmission deadline for 2020 data for the Income and Living Conditions (EU-SILC) indicators is 30 November 2021 while data were extracted on 22 October 2021; b = major substantive and methodological changes for DE.
Source: European Commission, Eurostat