[European Semester Winter Package: assessing Member States' progress on economic and social priorities]

Challenges vary significantly across countries and call for appropriate and determined policy action.

This review of country-specific challenges comes against the backdrop of a European economy that is expected to grow for the seventh consecutive year in 2019, but at a more moderate pace. Employment is at a record high and unemployment at a record low. Public finances have also improved across the board, although some countries are still facing high levels of debt. However, challenges remain. Productivity levels remain subdued, population ageing is intensifying and rapid technological change is having a significant impact on labour markets. Real household income remains below pre-crisis levels in some Member States. Youth unemployment has been significantly reduced, but is still unacceptably high in some Member States. At a time of more pronounced global uncertainty, it is crucial that EU Member States step up their action to boost productivity, improve the resilience of their economies and ensure that economic growth benefits all citizens.

Following the publication in November of the Annual Growth Survey and the recommendation on the economic policy of the euro area, which set out the priorities at European level, today's 28 Country Reports zoom in on the national dimension of the European Semester. The reports provide a detailed analysis of country-specific economic and social challenges. They will serve as the basis for discussions with Member States of their national policy choices ahead of their national programmes in April, and will lead to the formulation in late spring of annual Country-Specific Recommendations.

As a novelty of today's package, the Commission launches a discussion on investment challenges and priorities in the Member States and sets out first ideas as to how EU funds, in particular EU Cohesion Policy funds, can help in the forthcoming programming period 2021-2027. This will also serve to ensure greater coherence between the coordination of economic policies and the use of EU funds, which are a significant part of public investment in several Member States. This new focus is reflected throughout the Country Reports and a new annex on the possible use of future EU Cohesion Policy funds is attached to each Country Report.

Vice-President Valdis **Dombrovskis**, responsible for the Euro and Social Dialogue, also in charge of Financial Stability, Financial Services and Capital Markets Union, said: *"The European economy is experiencing its seventh consecutive year of economic expansion. Yet growth is slowing down. Maintaining momentum into the future will require a high level of competiveness, as well as continued upward convergence. To unlock the full growth potential of our economies, we need structural reforms. We also need well-targeted investment to bolster productivity growth across Europe."*

Marianne **Thyssen**, Commissioner for Employment, Social Affairs, Skills and Labour Mobility, said: *"Demographic change and new technologies are reshaping the labour market, while skills shortages are on the rise in many Member States. We need to shift up a gear. Investing in people's skills, especially lifting the skill levels of the low-skilled, must be our top priority if we are to maintain our living standards."*

Pierre **Moscovici**, Commissioner for Economic and Financial Affairs, Taxation and Customs, said: *"We have carried out an x-ray of all 28 EU economies, to identify problems and ensure they can be tackled in a timely manner. Many of Europe's imbalances are being corrected, thanks to both economic growth and policy action, though longstanding challenges remain. With growth easing this year, it is more important than ever that governments act to strengthen the resilience of our economies: reducing debt, boosting productivity, investing more and better, and tackling inequalities. Concerning Greece, the second Enhanced Surveillance Report also published today shows significant progress but also some areas in which further efforts are needed, and I urge the authorities to complete these in time for the next Eurogroup.*"

Corina **Creţu,** Commissioner for Regional Policy, said: *"The Country Reports feature an important novelty this year, with a strong focus on investment bottlenecks and regional disparities, and the Commission's assessment on how future EU funding should be invested in each country. This will help us kick-start the discussion on the Member States' investment priorities for the next decade and how Cohesion Policy funds can help."*

Progress with Country-Specific Recommendations

The Country Reports assess Member States' progress in implementing the Country-Specific Recommendations of July 2018. Overall, Member States have achieved some or more progress with the implementation of more than two-thirds of the recommendations issued since the introduction of the European Semester in 2011. Member States have made most progress on the recommendations on financial services, reflecting the priority given to the stabilisation and soundness of the financial sector in the aftermath of the financial crisis. Sound progress has also been achieved with regard to reforms facilitating job creation on permanent contracts and addressing labour market segmentation.

In recent years, one of the ways in which the Commission aims to help Member States step up their reform efforts is through its Structural Reform Support Programme (SRSP), which aims to provide technical support to all EU Member States, at their request, to help them design and implement growth-enhancing reforms. This also includes reforms highlighted in the Country-Specific Recommendations.

As part of today's package, the Commission also adopted the Structural Reform Support Programme's 2019 Work Programme. In 2019, the SRSP will provide technical support to 26 Member States to carry out more than 260 projects. This comes in addition to more than 290 projects selected in 2017 and 2018.

Addressing macroeconomic imbalances

In November, the Commission launched in-depth reviews for 13 Member States to analyse whether they were experiencing macroeconomic imbalances, and if so, how serious they were. The Commission has now concluded that imbalances or excessive imbalances exist in all of these 13 Member States, but the gravity of the imbalances has diminished in some cases. The summary of the in-depth reviews outcome is as follows:

– **Bulgaria, Germany, Spain, France, Croatia, Ireland, the Netherlands, Portugal, Romania and Sweden** are experiencing economic imbalances.

– **Cyprus, Greece and Italy** are experiencing excessive imbalances.

The Commission will continue reviewing developments and policy measures taken by all Member States with imbalances or excessive imbalances through specific monitoring in the context of the European Semester.

Opinion on the Draft Budgetary Plan of Slovenia

The Commission also publishes today its Opinion on the updated Draft Budgetary Plan (DBP) for Slovenia, as the one submitted last October was based on a "no policy change" scenario and was resubmitted in the meantime. The Commission considers that the updated DBP poses a risk of non-compliance with the provisions of the Stability and Growth Pact. Both Slovenia's Plan and the Commission forecast that the Draft Budgetary Plan might result in a significant deviation from the adjustment path towards the country's medium-term objective. Slovenia is invited to take the necessary measures within the national budgetary process to ensure that the 2019 budget will be compliant with the Stability and Growth Pact.

Enhanced Surveillance Report for Greece

For Greece, which joined the Semester process since it concluded its stability support programme last summer, the Commission has adopted the second report under the Enhanced Surveillance framework. The Report assesses Greece's progress with policy commitments made at the Eurogroup in June 2018. The Report concludes that while Greece has made considerable progress implementing its specific reform commitments due by end-2018, the pace in some areas has been slow and has led to delays in related key reforms.

Progress Report on National Productivity Boards

The Commission has also published the progress report on the implementation of the Council Recommendation of 20 September 2016 on the establishment of National Productivity Boards. The report analyses productivity and competitiveness developments in the EU and the euro area and provides an overview of the established productivity boards at the end of 2018. National Productivity Boards are already established in 10 euro area Member States. The remaining euro area Member States have all confirmed their intention to establish them soon. The existing boards, which due to country-specific contexts have different set-ups, are already actively contributing to domestic discussions on productivity-related challenges. The Commission has launched a network for the productivity boards to facilitate exchange of views, practices and experiences.

Employment Guidelines renewal

The Commission has also adopted a proposal to maintain the 2018 Council Decision on guidelines for the employment policies of the Member States. This year's proposal reconfirms the alignment of the Employment Guidelines with the 20 principles of the European Pillar of Social Rights, as their overall objectives and priorities remain valid. The Employment Guidelines present common priorities and targets for national employment policies and provide the legal basis for Country-Specific Recommendations in these areas, which have to be re-adopted every year.

Stocktaking Report on Member States' training and retraining strategies

The Commission also released today a report on the implementation of the Council Recommendation on "Upskilling Pathways", which is part of the new Skills Agenda for Europe put forward by the Commission in June 2016. Currently, there are 61 million adults in the EU who have at best lower secondary education. Through this Recommendation, Member States committed to offer adults with low levels of skills and qualifications new and improved opportunities to boost their basic literacy, numeracy and digital skills, and to progress towards higher qualifications. This report reviews the measures carried out by Member States, which differ in size and level of ambition. A lot of them are supported by the European Social Fund.

What next?

The Council is expected to discuss the Country Reports together with the results of the in-depth reviews. In the coming months, the Commission will hold bilateral meetings with the Member States in light of the analysis of the respective reports. The Vice-Presidents, Commissioners and Commission services will visit Member States to meet governments, national parliaments, social partners and other stakeholders and discuss the findings of the reports. These visits will also include dedicated discussions of the annexes on how future EU Cohesion Policy funds could help address specific investment needs in the Member States.

In April, Member States are expected to present their National Reform Programmes, detailing national reform priorities, and their Stability Programmes (for euro area countries) or Convergence Programmes (for non-euro area countries), setting out their multiannual fiscal strategies.

Based on all these programmes, the Commission will present in spring its proposals for a new set of Country-Specific Recommendations, targeting the key challenges to be addressed for 2019-2020. The recommendations will also include fiscal guidance. They will be based on the Commission Spring Forecast which will incorporate final 2018 budgetary data validated by Eurostat.

Background

This Winter Package is part of the annual cycle of economic policy coordination at EU level, the European Semester. It follows the publication in November of the 2019 Annual Growth Survey and the euro area recommendation (Autumn Package), which set the priorities for the year ahead at European level. It now zooms in on the national dimension of the European Semester.

It is based on the latest data from the Commission's Winter 2019 Economic Forecast and builds on the continuous dialogue with Member States' authorities and stakeholders to review progress made over time. The Country Reports provide the underpinning for the Member States to develop their national programmes by mid-April and for the Commission's upcoming Country-Specific Recommendations later in Spring (Spring Package).

Appendix – Findings from in-depth-reviews by Member State

Bulgaria is experiencing imbalances. Vulnerabilities in the financial sector are coupled with high indebtedness and non-performing loans in the corporate sector. The net external position has improved on the back of robust growth and large current account surpluses. Steps have been taken to strengthen the stability of the financial sector. Banks and other financial corporations have made further progress in implementing the recommendations addressed after the asset quality and balance sheet reviews and supervision has been strengthened. However, fragilities linked to weak governance, asset quality and supervision remain, while new challenges are emerging in the insurance sector. The robust growth has supported continuous private deleveraging and further decreases in non-performing loan ratios, but stocks of non-performing loans in the corporate sector are still elevated. While there is progress in addressing sources of imbalances, the full implementation and monitoring of recent reforms to supervision and governance in the bank and non-bank financial sectors will be crucial. More action is also needed to reduce the stock of non-performing loans and to complete the reform of the insolvency framework.

Cyprus is experiencing excessive imbalances. A very high share of non-performing loans burdens the financial sector and high stock of private, public, and external debt hangs on the economy, in a context of still relatively high, even though declining, unemployment and weak potential growth. The current account deficit is significantly negative, even taking into account the presence of special purpose entities, reflecting strong domestic demand as well as the negative saving among households, and is not adequate to guarantee a sustainable adjustment of the large stock of net external liabilities. Deleveraging of private sector debt is ongoing but only slowly. New lending to the private sector remains limited. The transfer of a significant portfolio of non-performing loans from the Cyprus Cooperative Bank to the public sector in the context of the bank's sale and wind-down reduced significantly the share of non-performing loans in the banking system. However, non-performing loans remain high for both households and corporations. The government support in the sale of the Cyprus Cooperative Bank had a one-off increasing impact on public debt in 2018. Looking forward, the high public debt is expected to be on a declining path on the back of a continued strong fiscal performance. Compared to last year, the reform momentum has been stepped up especially on the front of measures to address the vulnerabilities from non-performing loans, but more progress is needed on structural reforms to increase the growth potential.

Germany is experiencing imbalances. The high and slowly declining current account surplus reflects a subdued level of investment relative to saving in both the private and the public sector and has cross-border relevance. This is in spite of an increasing need for investment and innovation to make the German economy more resilient and to ensure a sustainable and inclusive growth model. The surplus slightly narrowed in 2018 in the context of a pick-up in domestic demand and is expected to continue to decline gradually in the coming years while remaining at a historically high level. Private and public investment have increased noticeably and there is a shift towards more domestic demand-driven growth. Yet investment but also consumption remain muted as a share of GDP despite the favourable financing conditions, the persistent infrastructure and education investment needs, especially at municipal level and the available fiscal space. The budget surplus grew in 2018 and the debt ratio declined further. Wage growth increased somewhat with the tightening labour market, yet real wage growth remains modest. While a number of measures have been taken to strengthen private and public investment, more efforts are needed to clear the large investment gap particularly as regards public investment in infrastructure and education. There has been less progress in other policy areas.

Greece is experiencing excessive imbalances. Vulnerabilities are linked to high government indebtedness, the negative external position, the high share of non-performing loans, incomplete external rebalancing, in a context of high although declining unemployment and low potential growth. Greece managed to successfully exit the European Stability Mechanism support programme in August 2018 after making substantial improvements in recent years. Nonetheless, large stock imbalances remain, including a deeply negative net international investment position that is still deteriorating amid moderate nominal GDP growth and a current account balance that remains negative. There have been considerable improvements in cost competitiveness in past years which stalled recently in light of subdued productivity growth. While the level of public debt remains high, it is mostly held by the official-sector creditors and financing needs will be relatively low for at least a decade. The pace of debt reduction crucially depends on the continued achievement of the agreed fiscal targets and implementation of reforms to generate a sustainable increase in the growth potential. The financial sector is vulnerable due to a very large stock of non-performing loans and a low profitability, hampering credit growth and the recovery of investment. Private debt is decreasing while active deleveraging is still ongoing. Wide-ranging measures were taken during the financial assistance programmes to address many of the structural weaknesses of the Greek economy. On top of consolidating earlier reforms and adjustment efforts, the authorities have committed to ensure continuity and completion of reforms, which are monitored in the framework of enhanced surveillance.

Ireland is experiencing imbalances. Large stocks of private and public debt and net external liabilities constitute vulnerabilities. However, stock imbalances are under substantial correction. The activities of multinational firms with little connection to the domestic economy heavily influence net foreign liabilities which are falling on the back of large current account surpluses. The stock of private debt remains high but economic growth continues to support private deleveraging. The activities of multinational enterprises continue to influence corporate debt. Household debt appears broadly in line with fundamentals although it is high compared with disposable income. Government debt is projected to remain on a downward trajectory, while the deficit is moving closer to a balanced position. House prices have been growing at a rapid pace for a number of years but have slowed down recently. House prices are largely driven by supply constraints and there is no clear evidence of overvaluation. The stock of non-performing loans, although still high, has decreased further even if long-term arrears are falling at a slower pace. Policy action addressing these vulnerabilities has been taken, notably in the field of housing supply and macroprudential policy, but some measures will take time to generate the expected effects.

Spain is experiencing imbalances. Though economic growth remains robust, large stocks of external and internal debt, both public and private, continue to constitute vulnerabilities in a context of, still high unemployment and have cross-border relevance. The rebalancing in the external sector has continued even if the current account surplus weakened in 2018, reflecting factors linked to the global environment. Sustained current account surpluses over an extended period of time will be needed to bring net external liabilities down to prudent levels. Debt reduction for the private sector also progressed, on the back of robust nominal growth. The non-performing loans ratio has decreased further. Public debt has decreased slightly, with narrowing deficits forecast to support its further gradual reduction. Still, further efforts will be needed to bring public finances onto a more sustainable path. Unemployment has continued its decline, but remains high. Implementation of policy action to raise potential growth has been slow. Challenges remain, in particular concerning labour market segmentation, research and innovation, and business regulation, notably for services.

France is experiencing imbalances. Vulnerabilities stem from high public debt and weak competitiveness dynamics in a context of low productivity growth, which carry cross-border relevance. Government debt was broadly stable in 2018, although at an elevated level. It is forecast to recede only marginally. The high level of public debt reduces the fiscal space available to respond to future shocks and weighs on growth prospects. Unit labour cost increases continue to be moderate in a context of low productivity growth. Some elements of the business environment still weigh on non-cost competitiveness. Reforms have been taken in recent years, with progress on several fronts including labour markets, taxation and business environment. However, the effects of these reforms still have to fully materialise while further action is warranted in other fields, such as the reform of the unemployment benefit system, the reform of the pension system, and the spending review to ensure the sustainability of public finances and to enhance the growth potential.

Croatia is experiencing imbalances. Remaining vulnerabilities are linked to high levels of public, private and external debtin a context of low potential growth. However, they have been narrowing over the past years. This was supported by robust nominal growth, above estimated potential, and a prudent fiscal policy. The negative net external position remains large, but has been improving due to continued current account surpluses. Private sector deleveraging is ongoing, though its pace is set to abate as credit growth and investment recover. The budget balance has been in surplus since 2017 and public debt has declined notably since its 2014 peak. The financial sector is well-capitalised and profitable while non-performing loans, although declining, remain elevated. The foreign currency exposure of corporations and households has reduced, but remains a vulnerability. Policy action has been stepped up with the adoption of a pension reform and new legislation to improve the fiscal framework. Other relevant policy measures are in the pipeline and their thorough implementation remains crucial for strengthening the resilience of the economy.

Italy is experiencing excessive imbalances. High government debt and protracted weak productivity dynamics imply risks with cross-border relevance, in a context of still high level of non-performing loans and high unemployment. The government debt ratio is not expected to decline in the coming years, as the weak macroeconomic outlook and the government's current fiscal plans, though less expansionary than its initial plans for 2019, will entail a deterioration of the primary surplus. Cost competitiveness is stable, but weak productivity growth persists. This is rooted in long-standing issues with the functioning of labour, capital and product markets, compounded by weaknesses in the public administration and justice system, which drags down potential GDP growth. The stock of non-performing loans has continued to decline significantly, but maintaining the pace of reduction of non-performing loan could prove challenging given market conditions. Higher sovereign yields compared to the levels of early 2018 are affecting banks' funding costs and capital buffers weighing on lending to the rest of the economy and on GDP growth. Despite some progress in banks' balance sheet repair, insolvency reforms and active labour market policies, the reform momentum broadly stalled in 2018. The 2019 budget includes policy measures that reverse elements of previous important reforms, in particular in the area of pensions, and does not include effective measures to increase potential growth.

The Netherlands is experiencing imbalances. The high stock of private debt and the large current account surplus constitute sources of imbalances, with cross-border relevance. The surplus peaked in 2017 at a very high level, and it is expected to decline gradually although remaining very elevated. Part of the external surplus can be attributed to statistical features linked to the role of multinational companies and is not expected to attenuate in the near future. Supported by economic growth, the private debt-to-GDP ratio has continued its downward trend both for corporate and households, although remaining elevated. Nevertheless, nominal household debt is slowly increasing on the back of dynamic house price growth. Wage growth has so far been moderate despite the tightening labour market. Recent reforms, such as the speeding-up of the reduction of mortgage interest deductibility, are expected to reduce the debt bias for households, while fiscal stimulus is expected to contribute to support aggregate demand.

Portugal is experiencing imbalances. The large stocks of net external liabilities, private and public debt, and a high share of non-performing loans constitute vulnerabilities in a context of low productivity growth. The current account is broadly balanced but a continued prudent position and the maintenance of competitiveness gains are required to ensure the adjustment of net external liabilities to prudent levels. Private debt ratios continue to decline from high levels on the back of nominal growth with a reduced role of active deleveraging. Government debt started declining as from 2017 backed by primary surpluses while remaining elevated. Risks in the banking sector have diminished including in light of recapitalisations of major banks in 2017 and a recent improvement in profitability. The large stock of non-performing loans has decreased but remains comparatively high. Ensuring higher productivity growth is key for improved prospects in competitiveness, deleveraging and potential growth. The labour market adjustment has progressed further and unemployment has been decreasing at a strong pace for several years. There has been policy action to address the level of non-performing loans but policy gaps remain in other areas, such as product and service markets. The adoption and implementation of several reform plans, including fiscal-structural reforms to improve the sustainability of public finances, will need to be monitored.

Sweden is experiencing imbalances. Overvalued house price levels coupled with a continued rise in household debt poses risks of a disorderly correction. The high household debt has continued to grow as a share of GDP. There has been a correction of house prices in the second half of 2017 which have since then gradually stabilised. Nevertheless, valuation indicators suggest that house prices remain high relative to fundamentals. Although the banking sector appears adequately capitalised, a disorderly correction would negatively affect the financial sector given the large exposure to household mortgages. In such a case, there could also be negative spill-overs to neighbouring countries given the systemic financial interlinkages. Structural bottlenecks for housing supply persist and construction output has weakened. Although measures have been taken in recent years in the macro prudential field to address mortgage debt growth, the impact appears so far limited. Key policy gaps remain, particularly in relation to tax incentives for home ownership and the functioning of housing supply and the rental market.

Romania is experiencing imbalances. Vulnerabilities are linked to cost competitiveness losses and a widening current account deficit in a context of an expansionary fiscal policy and an unpredictable business environment. Recent legislative initiatives create risks for the functioning of the financial sector and may harm private investment. The current account deficit has been growing on the back of buoyant imports, mainly for consumption purposes, and is forecast to widen further. The strong nominal GDP growth has nevertheless implied that the negative Net International Investment Position has been improving for some years but this may stall with the persistency of the current account deficits and lower GDP growth looking forward. Demand is fuelled by strong wage growth, inter alia linked to hikes in public wages and the minimum wage, which has translated into very substantial increases in unit labour costs. Despite cost competitiveness losses, so far export market shares have been growing. The expansionary fiscal stance, in a context of strong GDP growth, is forecast to continue thus contributing to buoyant private consumption dynamics. After declining for some years, the government debt ratio is projected to increase. Frequent and unpredictable legislative changes contribute to a weaker and uncertain business environment, with negative repercussions on business decisions and investment. Recent legislative initiatives with impact on banks' risk threaten the functioning of the financial sector and may hinder investment through both a tighter credit market and a shallower capital market with weaker institutional investors. In other areas, progress with reforms has slowed down or reversed.

Further Information

Memo: European Semester Winter Package

28 Country Reports

Communication on the main findings of the Country Reports

Opinion on the 2019 Draft Budgetary Plan of Slovenia

Second Enhanced Surveillance Report for Greece

Annual Work Programme of the Structural Reform Support Programme (SRSP)

Updated Employment Guidelines for 2019

Progress Report on the Council Recommendation on "Upskilling Pathways: new opportunities for adults"

Progress Report on the Council Recommendation on the establishment of National Productivity Boards

Timeline of the European Semester cycle

Previous publications

Annual Growth Survey 2019

Alert Mechanism Report 2019

Euro area recommendation 2019

Draft Joint Employment Report 2019

European Pillar of Social Rights and the Social Scoreboard

Winter 2019 Economic Forecast

Start of the 2019 European Semester: Autumn Package

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