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2018 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011

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1. INTRODUCTION

Europe's economy is experiencing the highest growth in a decade. Yearly GDP growth has reached last year a ten-year high. Investment is picking up. The positive economic outlook included improving labour market and social outcomes. With 236.3 million people currently working in the EU, employment is at record levels. The unemployment rate is almost back down to its pre-crisis level. Continued labour market improvements are driving up income prospects. Public finances continue to improve. And with growth of 2.4 % in real terms in 2017, the EU economy and euro area are outperforming earlier expectations and are playing a full part in the robust growth at global level.

This momentum looks set to continue on the back of positive news on economic sentiment and domestic demand.[1] Euro area and EU GDP is forecast to expand by 2.3 % in 2018. It will then ease somewhat off to 2.0 % in 2019. At the same time a number of risks remain, notably from the financial markets as a result of high asset valuations that may be vulnerable to less supportive financial conditions. Also risks related to the outcome of the negotiations on the United Kingdom's withdrawal remain, as do geopolitical tensions and a shift towards more inward looking policies.

The favourable conditions have opened a window of opportunity to further strengthen the foundations of Europe's economies. At the same time, the remaining risks remind of the necessity to do so, continuing our efforts to overcome the core legacies of the crisis. High levels of corporate, household and public debt remain in some Member States. Moreover, the economic expansion has been uneven across and within Member States, and it will take time to be equally felt in all parts of Europe. 18 million people are still seeking a job, with youth and long term unemployment still significantly high in some countries. Disposable households´ income is not yet above pre-crisis levels in all Member States. The share of people at risk of poverty or social exclusion is just back to pre-crisis levels. The process of economic and social convergence has started again, while structural weaknesses are holding back some countries' potential to grow and their capacity to face future shocks. At the same time, technological change prompts the economies to embrace innovation while making sure societies remain as inclusive as ever. Now is the time to pursue the reforms needed to make Europe's economies more resilient and to create more inclusive growth.

With its continued focus on the 'virtuous triangle' of investment, structural reforms, and responsible fiscal policies, the European Semester continues to guide Member States in taking the necessary reforms. The 2018 Annual Growth Survey provides this economic guidance to Member States, in line with President Juncker's 2018 State of the Union address. The recommendation for the economic policy of the euro area in 2018[2] stresses the need for reforms to promote quality job creation, social fairness, rebalancing and convergence, higher investment, the quality of public finances, the completion of the Banking and Capital Markets Unions, and deepening the Economic and Monetary Union. The recommendation also calls for fighting aggressive tax planning. It calls on all Member States to prioritise reforms that increase productivity and growth potential, improve the institutional and business environment, remove bottlenecks to investment and foster innovation, support the creation of quality jobs and reduce inequality. Member States with current account deficits or high external debt should additionally contain unit labour cost growth and improve their

[1] See European Economic Forecast, Winter 2018.

[2] The euro area recommendation was adopted by the Council on 23 January 2018. It provides overall orientation on main economic and financial challenges for the euro area and its Member States, thereby guiding the process leading to the issuance to country specific recommendations to euro area Members States.

competitiveness, while Member States with large current account surpluses should also create conditions to promote wage growth, while respecting the role of social partners, and to foster investment to support domestic demand and growth potential.

The European Semester has been enriched this year by building on the European Pillar of Social Rights. The Pillar was proclaimed by the European Parliament, the Council and the Commission, in November 2017 at the Social Summit for Fair Jobs and Growth in Gothenburg. A key message of the 2018 Annual Growth Survey is the need to implement the Pillar for a renewed convergence towards better working and living conditions across the EU. This requires fair and well-functioning labour markets, as well as modern education and training systems that equip people with skills that match labour market needs. This should be supported by sustainable and adequate social protection systems. The country reports published today look at how Member States deliver on the three dimensions of the Pillar: equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion. The provision of adequate skills and persistent gender employment gap, high labour market segmentation and the risk of in-work poverty, the low impact of social transfers on poverty reduction, sluggish wage growth, and ineffective social dialogue are areas of particular concern in some Member States. In order to analyse Member States' performances in a comparative perspective, the country reports also build on the benchmarking exercises conducted on unemployment benefits and active labour market policies and on minimum income.

The country reports published today will underpin the Commission's upcoming country-specific recommendations later this spring. These 27 country reports[3] review economic and social developments, challenges and opportunities for the Member States. A number of in-depth reviews were carried out in the context of the Macroeconomic Imbalances Procedure, following the 2018 Alert Mechanism Report, and their conclusions are an integral part of the reports for Bulgaria, Croatia, Cyprus, France, Germany, Ireland, Italy, the Netherlands, Portugal, Slovenia, Spain, and Sweden. The country reports also review Member States' progress with the implementation of the country-specific recommendations over the years, by taking a multi-annual perspective, as is now done under the European Semester cycle to account for the time needed for the full implementation of critical reforms. Last but not least, the country reports trace progress towards the Europe 2020 targets.

2. PROGRESS WITH COUNTRY SPECIFIC RECOMMENDATIONS

Member States continue to make progress in addressing the country-specific recommendations adopted by the Council in the context of the European Semester. Reform implementation has slightly increased overall, as compared to the May 2017 stocktaking exercise.[4] This is encouraging and reflects that important reforms have been carried out, but sometimes take longer to implement than anticipated. Since the start of the European Semester in 2011, Member States achieved at least 'some progress' with regard to more than two-thirds of the recommendations.

Reform implementation has been solid in some key areas. Since the outset of the European Semester in 2011, Member States have made most progress in financial services and in fiscal policy and fiscal governance. This continues to reflect the priority that was given to the

[3] No country report is provided for Greece which is under the European Stability Mechanism Stability Support Programme.

[4] Communication from the Commission to the European Parliament, The European Council, the Council, the European Central Bank, The European Economic and Social Committee, The Committee of Regions and the European Investment Bank, 2017 European Semester: Country-specific recommendations COM(2017) 500 final.

stabilisation of public finances and of the financial sector, following the economic and financial crisis. Significant progress has also been made in addressing access to finance, in employment protection legislation and frameworks for labour contracts. However, more modest progress has been made in areas like the broadening tax bases or transport. In many Member States, progress towards addressing the important challenges related to long-term sustainability of public finances is slow, including pensions. Regulatory reforms have improved the business environment especially in those Member States that needed them most. These reforms have reduced administrative barriers to the creation of new business. However, entrepreneurship remains weak in many Member States. Access to bank credit and loans have improved for SMEs but venture capital is still insufficient in many parts of the Union. Significant progress can also be reported in public procurement. Unfortunately, the pace of reform in services markets is slow in particular in business services, construction and real estate.

Member States are making progress towards the goals they set eight years ago in the Europe 2020 strategy.[5] Overall, the EU is approaching its targets on education, energy, climate and employment. 14 Member States have already achieved their national targets in reducing early school leaving and in increasing the share of tertiary educated population. 11 Member States have hit their renewable energy targets. The EU target of 75% employment in 2020 is on track assuming the current trend continues and seven Member States have already attained their national goals. This is a remarkable achievement given the severe impact of the crisis on employment. However, the number of the people at risk of poverty or social exclusion peaked in 2012 and has since then decreased to around pre-crisis levels. As a result, the target of lifting 20 million people out of poverty is unlikely to be met in 2020. Likewise, the goal of 3% of GDP investment in R&D is far from sight and no efforts should be spared to reach it in time.[6] Appendix 2 provides an overview of progress towards Europe 2020 targets.

The EU has at its disposal a set of tools to support the Member States in implementing their reforms. The Structural Reform Support Programme (SRSP) offers hands-on technical support to all EU Member States, at their request, for the design and implementation of reforms, and especially in the follow-up to the European Semester recommendations.[7] The EU budget, including through the European Structural and Investment Funds, is proving to be a powerful instrument to support investment in cohesion, education and training, connectivity (transport, energy, and digital infrastructure – also in the context of the Connecting Europe Facility), innovation, environment and support to SMEs. These funds have also crucially contributed to improving the investment environment through ex-ante conditionalities. In 2017, the Commission completed assessing their fulfilment; the very few cases of non-fulfilment are being followed up. The European Fund for Strategic Investments (EFSI) plays a

[5] These goals include increase of employment rate of the population aged 20-64 to 75%, increase of investment in R&D to 3% of GDP, 20% reduction of greenhouse gas emissions, 20% increase of the share of renewable energy in final energy consumption and 20% increase in energy efficiency, reduction of school drop-out rates to less than 10%, increase of the share of the population aged 30-34 having completed tertiary education to 40% and lifting at least 20 million people out of the risk of poverty and social exclusion.

[6] The reference year for the data is 2016.

[7] The demand for technical support from the Structural Reform Support Programme significantly exceeded the means available for 2017 and 2018. Under SRSP 2017, more than ten Member States were selected to receive support for over 150 projects. Today, a Financing Decision was adopted for SRSP 2018, under which the Structural Reform Support Service will provide support to over twenty Member States through over 140 projects supporting the implementation of reforms relevant for the European Semester or other Union-wide policy initiatives, such as the Single Market Strategy, the Digital Single Market, the Energy Union, the Capital Markets Union and the European Pillar of Social Rights.

major role in catalysing private investment, showing how the EU budget can rapidly respond to challenges and create substantial leverage.[8]

As part of the package on deepening Europe's Economic and Monetary Union presented on 6 December 2017, the European Commission proposed a reform delivery tool to further strengthen support to national reforms post 2020. [9] It also proposed a pilot phase until 2020. The Commission intends to present its more detailed ideas for the new reform delivery tool as part of its proposals for the post-2020 Multiannual Financial Framework.

3. ADDRESSING MACROECONOMIC IMBALANCES

The Macroeconomic Imbalances Procedure aims at preventing the emergence of potentially harmful macroeconomic imbalances and, where such imbalances had been identified, to ensure that Member States concerned take adequate action to correct them. Harmful macroeconomic imbalances can adversely affect economic stability in a particular Member State, the euro area, or the EU as a whole. This is why their timely and effective correction is so important. The in-depth reviews provide a comprehensive analysis of the imbalances experienced by the Member States, allowing for the identification of remaining vulnerabilities and, in the broader context of the European Semester, the identification of remaining policy gaps.

The 2018 Alert Mechanism Report found that 12 Member States' macroeconomic imbalances warranted an in-depth review. All of these countries were considered as experiencing imbalances or excessive imbalances in 2017 in the context of the Macroeconomic Imbalances Procedure. This categorisation has been supported by the Council in its conclusions on the Alert Mechanism Report[10]. As every year, country reports analyse macroeconomic developments, the correction of imbalances and progress with the response to relevant policy recommendations[11], also taking into account cross-border implications.

Structural reforms implemented under the Macroeconomic Imbalance Procedure have paved the way for the rebalancing achieved. The current favourable economic momentum should be used to pursue them vigorously. The recovery can contribute to sustainably tackling imbalances only through a continuation of reforms to support competitiveness, resilience and higher growth potential. Given the positive cyclical conditions, all Member States should prioritise reforms that increase their growth potential, improve the institutional and business environment, remove bottlenecks to investment, support the creation of quality jobs and reduce inequality.

3.1. Rebalancing in the EU and the euro area

The correction of macroeconomic imbalances continues to advance, supported by reforms and the economic expansion. Nevertheless, some vulnerabilities remain and new risks emerge. Progress in addressing external imbalances has been uneven, with large current

8 As of February 2018, the European Fund for Strategic Investments has triggered EUR 264.3 billion of total investments.

9 Communication from the Commission to the European Parliament, The European Council, the Council, the European Central Bank, New budgetary instruments for a stable euro area within the Union framework, COM(2017) 822.

10 Council Conclusions 5542/18 of 23 January 2018.

11 Article 2 of Regulation (EU) No 1176/2011 defines imbalances as "any trend giving rise to macroeconomic developments which are adversely affecting, or have the potential to adversely affect, the proper functioning of the economy of a Member State or of the economic and monetary union, or of the Union as a whole".

account deficits having been corrected, but with persistent large current account surpluses. Stock imbalances – notably private and public debt levels – are adjusting, helped by nominal growth, but progress is unequal. Stocks of net foreign liabilities remain high in a number of countries. Given that internal and external stock imbalances only adjust slowly, despite recent improvements in flows, they remain a source of risks in many Member States. Mainly in countries without identified imbalances at present, there are signs of a possible overheating in housing prices.

The current account surplus for the euro area as a whole has grown considerably over recent years. The euro area current account has stabilised and is forecast to stay around 3% of GDP until 2019. This large surplus has been reflecting weaknesses in aggregate demand, including sluggish wage growth, associated with below-potential economic output since 2009. The output gap for the euro area is however forecast to turn positive in 2018 but Euro-area wide economic slack has underpinned inflation below the target of monetary authorities, which also reflects subdued wage growth despite tightening labour markets. The evolution of the euro area current account surplus is also linked to the dynamics of euro area exports, building on the competiveness of European producers and supportive global demand for European goods and services.

The deleveraging of private debt is ongoing, at uneven pace. Persistently high private debt in a number of countries, often compounded by high government debt, is constraining investment and reduces the room to weather potential shocks. Reductions in debt-to-GDP ratios, including government debt ratios, are increasingly benefiting from higher nominal growth, while borrowing by households and non-financial corporations is edging up. Deleveraging has been faster in the corporate than in the household sector in most Member States. Some high debt countries are reducing their liabilities more slowly than low debt countries. Moreover, in most high debt countries, government debt has only recently started declining.

The situation of the banking sector has improved significantly but continues to face challenges. Most Member States have lately witnessed notable improvements in capital ratios and stocks of non-performing loans have also been falling significantly.[12] Profitability and market valuation of banks have also recovered in most Member States, together with credit flows. In a few countries however, stocks of non-performing loans still remain high and reduce the room for lending, whilst low profitability hampers provisioning efforts and the internal generation of capital, and reduces opportunities for raising capital in the market.

House prices are accelerating in most Member States; possible overheating risks deserve monitoring. Valuations are below earlier peak levels after the downward post-crisis adjustment, but in some cases indicators point to overvaluation. Signs of possible overheating are present and price dynamics are accelerating in a growing number of countries, including in countries not identified with imbalances, where these risks appear not of an immediate concern. Furthermore, the social impact of rising housing prices is a concern in some countries, highlighting the need for investment in adequate social housing and other housing assistance.

Employment continues to expand at a steady pace in Europe, though vulnerabilities remain in some Member States. Labour markets have continued to improve. Though

[12] See Communication from the Commission: First progress report on the reduction of non-performing loans in Europe, COM(2018) 37 final. The total volume of non-performing loans across the EU is still at the level of EUR 950 billion, clearly above pre-crisis levels. It is however on a steady declining trend, and the average ratio of non-performing loans has decreased by one-third since 2014.

declining across the board, unemployment remains high in some countries, notably among young people and the long-term unemployed. Underutilisation of the labour force is falling but remains sizeable even in countries where unemployment is low. Wage developments remain moderate in most countries and sectors. Poverty risks are generally receding but high in some countries.

3.2. Implementing the macroeconomic imbalances procedure

The Commission has reviewed economic developments and policy measures taken by all the countries with imbalances or excessive imbalances in the framework of specific monitoring. The Council has supported the conclusions of the specific monitoring reports. The scope and format of in-depth reviews and the categorisation of imbalances in the Macroeconomic Imbalances Procedure framework has remained stable.

The number of Member States identified with imbalances or excessive imbalances is declining. In 2017, six Member States were identified with imbalances and six with excessive imbalances. These twelve Member States were retained for further analysis also in 2018. The in-depth reviews have found that one Member State is not experiencing imbalances, eight are experiencing imbalances and three are experiencing excessive imbalances. Appendix 3 summarises the findings from the in-depth reviews by Member State.[13]

Table 1: Outcome of the in-depth reviews over 2017-2018

	Outcome of 2017 IDRs	Outcome of 2018 IDRs
No imbalances	FI	SI
Imbalances	DE, IE, ES, NL, SI, SE	BG, DE, IE, ES, FR, NL, PT, SE
Excessive imbalances	BG, FR, HR, IT, PT, CY	CY, HR, IT

In-depth reviews indicate that risks are declining in a number of countries, which implies a revision of the respective MIP categorisation.

- **Slovenia,** identified with imbalances in 2017, is found to be experiencing ***no imbalances***. Stability risks have receded to lower levels, and progress with the implementation of policy recommendations over past years has been overall satisfactory and is currently ongoing.
- **France,** identified with excessive imbalances in 2017, is found to be experiencing ***imbalances***. Economic developments and enhanced policy action have contributed to a gradual correction of existing challenges, leading from a revision of the categorisation towards reduced risk.
- **Bulgaria** identified with excessive imbalances in 2017, is found to be experiencing ***imbalances***, as policy action and a favourable macroeconomic environment are reducing imbalances, notably on the external side. Further efforts remain necessary to achieve a sustainable correction of the imbalances. The Commission will monitor

[13] For Greece, the surveillance of imbalances and monitoring of corrective measures has been taking place in the context of ESM stability support programme.

closely policy commitments, notably the next National Reform Programme (NRP), and the evolution of imbalances in the context of the specific monitoring.

- **Portugal** identified with excessive imbalances in 2017, is found to be experiencing ***imbalances***, as policy action and the context of favourable macroeconomic and financial conditions are reducing the balance of risks in terms of public and private sector debt as well as external debt. The unemployment rate in particular, dropped considerably and is now at pre-crisis levels. Further efforts remain necessary to achieve a sustainable correction of the imbalances. The Commission will monitor closely policy commitments, notably the next National Reform Programme (NRP), and the evolution of imbalances in the context of the specific monitoring.

Developments are generally favourable in the remaining countries analysed in the in-depth-reviews.

- Germany, Ireland, Spain, the Netherlands and Sweden are identified, as in 2017, to be experiencing ***imbalances***. Among these countries, a favourable macroeconomic environment is contributing to the reduction of stock imbalances in **Ireland** and **Spain**, although recent policy advancement has been modest and uneven in Spain. In the **Netherlands**, the authorities have made strong commitments to address imbalances, but these have yet to be implemented. Progress on the front of the correction of imbalances is limited in **Germany**, where private and public investment, whilst increasing, has still room to grow. In **Sweden**, progress is also limited, despite the first signs that house price growth might be cooling down.

- Cyprus, Croatia and Italy are identified, as in 2017, to be experiencing ***excessive imbalances.*** Imbalances are being reduced in **Croatia** and **Italy**, supported by a combination of reforms, favourable economic conditions and a reduction of risks in the banking sector. There is however a need for more determined policy implementation, notably in Croatia. No tangible improvement is recorded in **Cyprus**, where policy implementation has also been rather limited.

4. MEMBER STATES POLICIES

The present economic situation reflects the benefits of reforms taken in the recent past and provides a window of opportunity to address pending reform needs. The benefits of structural reform in Member States in the past years are being felt across Europe. The degree of these benefits – in terms of declining unemployment, raising incomes, and renewed convergence –reflects differences in recent reform activity. Further momentum to reform economies, public administrations and welfare systems would help to improve the resilience of Europe's economies and societies and weather macroeconomic shocks in the future. Adaptation to ongoing structural change would help narrowing differences in productivity, and improve social outcomes. Reforms will also help our economies to sustain the current expansion by removing supply side constraints. The present favourable economic outlook must not nurture complacency.

It might take time before the benefits of reforms are fully felt, but experience shows that reforms work and that today's favourable conditions provide the right environment. Many reforms do not have significant pecuniary costs. Keeping short-term economic costs low and distributing them fairly can strengthen their efficiency and public support. This calls also for careful sequencing and packaging of measures. For example, certain labour and product market reforms may have short-term costs as compared to long-term benefits, and tend to reinforce each other's impacts. In addition they can be supported by reforms that

improve the quality and composition of public finances and in some Member States, by the use of the available fiscal space. In general, the political cost of implementing reforms tends to be lower during good economic times. This is yet another strong reason not to forego the opportunity provided by the present economic situation.

Reforms require sound preparation and adequate administrative and technical capacity. Reforms to enhance administrative capacity, efficiency and quality are an enabler of reforms. Reforms of public administrations have limited short-term costs and can be effective at any point of the cycle. They can be mutually supportive for other well-designed reforms that have important benefits in the form of confidence effects also in the short term. Building awareness of benefits, developing common ground amid divergent stakeholder interests, and putting focus on the common good is facilitated by sound preparatory work by an adequate administration. Timely implementation of some reforms may involve having appropriate legal and technical (e.g. IT) conditions in place. Achievable and measurable outcomes of reforms need to be specified, monitored, and communicated. The Commission's Structural Reform Support Programme provides substantial technical support to Member States to provide the appropriate ground for successful reforms (see section 2).

The involvement of national stakeholders, including social partners, is instrumental to successful, sustainable reforms. Stakeholders' co-ownership of reforms improves the outlook on realisation and helps attaining appropriate outcomes, also in terms of fairness. While there is scope for going further, Member States have taken steps to better involve social partners in the design and implementation of reforms. Estonia, Latvia, Lithuania and Slovakia have used support from the European Social Fund to enhance social partners' capacity to contribute to designing key reforms. The French government invited social partners to negotiate a reform of the unemployment insurance. Italian social partners signed a new agreement on the representativeness of trade unions. In Denmark, a tripartite agreement on adult education and training aims to improve upskilling. In Portugal, following the publication of a Green Book on Labour Relations, the government began discussions with social partners on measures to tackle labour market segmentation. In the Netherlands, social partners are being closely involved in the reform of the pension system. Some Member States also involve civil society organisations in designing reforms.

4.1 Responsible fiscal policies, effective and fair taxation, financial stability

Across the EU, public deficits and debt continue to decline, mainly on the back of accelerating growth and low interest rates. In the context of a further strengthened economic outlook, the Commission expects the headline government balance to improve further in the EU, with subsequent reductions of the debt-to-GDP ratio in almost all Member States in the years ahead. The current supportive economic environment provides opportunity to build up the fiscal buffers necessary to strengthen to resilience to shocks.

Fiscal governance has been improved in a number of Member States; continuing improvements would help make public finances more sustainable and predictable. Bulgaria recently amended its Public Finance Act aiming to achieve full compliance with EU requirements. In the Czech Republic, a new fiscal responsibility law has significantly strengthened fiscal governance. Lithuania refined the application of its national expenditure rules and accountability for meeting fiscal targets. Malta is introducing accrual accounting in all government departments. All Member States except Poland and the Czech Republic, pending parliamentary endorsement of members in the latter, have in place independent fiscal councils. Some challenges to national fiscal governance still prevail though. The financial

autonomy of independent fiscal institutions could be strengthened in some Member States. Better coordination of fiscal planning across levels of government is needed in Member States with federal constitutional structures.

Rigorously implemented expenditure reviews are conducive to spending taxpayers' money efficiently. They have the potential to improve the outcomes of public policy and allocation of public funding across policy priorities, while maintaining fiscal responsibility. Spending reviews are ongoing in many Member States.[14] For example, Spain mandated its independent fiscal institution, AIReF, to carry out a review across government levels. Some initiatives are also underway outside the euro area, for example in Bulgaria where a spending reviews focusing on maintenance and staff expenditure in several ministries and municipalities is ongoing.

Both public and private investment need to be safeguarded to strengthen the growth potential of the euro area. In the case of public spending, this can be achieved through a right fiscal composition and improving the quality of public finances. Some Member States have adopted multi-annual plans to boost spending on public investment. France adopted a 'Grand plan d'investissement 2018-2022' to prepare the economy for future challenges. Ireland further developed its 'Capital Investment Plan for 2018-2021' to tackle infrastructure bottlenecks that have resulted from reduced public investment in the aftermath of the crisis in areas such as housing, transport and water infrastructure. Germany made progress in addressing capacity and planning constraints for infrastructure investments, in specific sectors, such as transport. Efforts should continue to mobilise private investment, including through Public Private Partnerships.

Healthcare and pension reforms are needed to maintain sustainability, accessibility and quality of the respective systems, while ensuring adequacy. Together with the faster growth of the population groups over 60 and technological progress in healthcare, healthcare and pensions are among the largest and fastest-growing public spending sectors. Informal payments to obtain differentiated treatment and access to healthcare are still an issue in some Member States and have important negative consequences for universal access to healthcare and the sustainability of healthcare. Most Member States have taken action in the pension and healthcare field in recent years, however the year-to-year progress seems to be rather modest. More recently, Slovakia is improving the cost-effectiveness of the healthcare system, including by implementing the value-for-money project which appears to have generated some positive, tangible changes leading to savings. Denmark adopted new incentives to opt out of the early retirement scheme in order to postpone retirement and also Lithuania and Portugal undertook reforms to limit the negative impacts of some aspects of their pension systems on long-term fiscal sustainability. These good practices need to be followed more broadly to maintain public finance sustainability and thus guarantee citizens healthcare and pension coverage, also in the interest of intergenerational fairness.

Fair and growth-friendly tax systems can help support private investment and improve the business environment, encourage employment, reduce inequalities and contribute to an environmentally resilient economy. Belgium is gradually implementing a tax shift away from labour. In France, the tax credit for employment and competitiveness is to be converted into permanent reductions in employers' social security contributions and accompanied with a further reduction for the lowest wages. Latvia and Hungary have slightly reduced their

[14] Source: June 2017 Commission note to the Eurogroup based on a survey to the euro area, http://www.consilium.europa.eu/media/23582/eg-15-june-2017_note-on-spending-reviews.pdf

relatively high tax wedge for low income earners. In Sweden, tax measures are supporting a greener, more sustainable economy.

Aggressive tax planning entails significant losses to European taxpayers; the transposition of EU legislation will help curtailing such practices. Revenue losses from profit shifting within the EU alone are estimated at EUR 50-70 billion. Aggressive tax planning distorts the playing field among companies, and unfairly diverts resources from governments' spending objectives. Tax abuse can be reined in by strengthening national tax legislation, increasing transparency, and cooperation among governments. Belgium, Cyprus, Malta and the Netherlands are amending aspects of their tax systems that have facilitated aggressive tax planning. In Ireland, the recommendations of an independent review of the corporation tax code have been submitted to public consultation. By the end of 2018, Member States have to transpose the provisions of the Anti-Tax Avoidance Directive (ATAD) into their national law.

Measures taken to strengthen the banking sector and tackle high levels of non-performing loans are bearing fruit and need to be further stepped up. In July 2017, the Council agreed an EU action plan to reduce the stocks of non-performing loans in the banking sector and prevent their future emergence.[15] The actions on bank supervision, the reform of insolvency and debt recovery frameworks, the development of secondary markets for distressed assets, and the restructuring of the banking industry need to be pursued vigorously, to improve bank profitability, the transmission of monetary policy, and the financing of economic activity. Italy's efforts, including the set-up of a securitisation scheme for non-performing loans, show effects. The Bank of Slovenia issued a toolkit to prevent, identify and manage non-performing loans. Ireland and Croatia also promoted the clean-up of non-performing loans, such as by amendments of the tax rules. However, the level of non-performing loans still remains high in some Member States, and depresses the profitability of smaller banks in particular.

4.2 Resilient and inclusive labour markets, education systems and social policies

Notwithstanding the employment rate in Europe being now the highest ever and poverty and social exclusion having started to come down, important challenges remain. Unemployment and the number of people at risk of poverty are still too high, which manifests the fact that the recovery is still not reaching all parts of society and the economy. Apart from having to overcome the burdens of the past, labour markets and social and education systems need to adapt to face challenges of globalisation and technological progress.

Sustainable and inclusive social protection systems are central to mitigating the impact of economic shocks. In line with the principles of the European Pillar of Social Rights, all workers should have access to social protection, irrespective of the type and duration of their working relationship. However, increasing labour mobility and new forms of employment are trends not easily matched by social protection systems. Denmark, France, Italy, Poland and Portugal started reforms in this field, such as extending the coverage of social rights and unemployment benefits to people in non-standard and self-employment. In Portugal, this includes plans to reinforce its activation of recipients' capacity, for instance by improving the cooperation between employment and social services. Belgium is taking action by providing additional support for pension build-up of self-employed individuals and a reduction of the

[15] See Council conclusions on Action plan to tackle non-performing loans in Europe from 11.7.2017 and Communication from the Commission: First progress report on the reduction of non-performing loans in Europe, COM(2018) 37 final.

social security contribution limit for self-employed at the start of their activities. In Sweden, further to the compulsory unemployment insurance, self-employed workers can opt for a State-subsidised top-up. France announced reform of the unemployment benefit system to encourage firms' use of longer work contracts.

Box 1: Sustainable, adequate and effective social safety nets in Europe

In the European Pillar of Social rights, several principles, notably principles 12 and 14[16] underline the importance of adequate social protection. Adequate social protection, including old-age pensions, healthcare, unemployment benefits and social assistance is critically important for mitigating the hardship felt by people and families when confronted with job losses or other set-backs. This is especially important in a world of rapid transformations due to ageing, technology and globalisation, to support people during career transitions and help them fully embrace the opportunities and address the challenges that the fast-changing economy provides. On a larger scale, adequate and effective social protection is essential for a thriving economy and well-functioning labour markets that create quality jobs and sustainable growth. The long-term fiscal sustainability of social protection systems can only be ensured if the risk sharing inherent in social protection is widely spread.

Many Member States are modernising their social protection systems, by improving coverage and adequacy of benefits and services, notably for non-standard workers, and actively encouraging labour market participation. Several Member States, such as Italy, Denmark, Latvia, Portugal and France extended last year social protection coverage for the self-employed. Member States are also taking action to more actively support labour market participation, often with a focus on specific groups. Slovakia is implementing an ambitious action plan in support of Long Term Unemployed persons to provide tailor-made services. In Spain, a Social Inclusion Network was created as a coordination tool between social and employment services.

However, globally a more comprehensive and coherent approach is needed to address the challenges shared by Member States. The considerable job creation of recent years has already helped. Whilst having a job remains the best insurance against poverty, close to 10% of workers are classified under "in-work-poverty". And this share is slowly increasing in a context of changing labour markets.

Last but not least, the depth and persistence of poverty is increasing in some Member States, pointing to gaps in the social protection design and implementation. For example, Italy introduced a universal minimum income support scheme in March 2017 and further resources were structurally allocated by the 2018 Budget Law. Portugal made important changes to the minimum income scheme to reinforce its capacity to integrate and protect persons living in poverty, without discrimination by nationality. Nevertheless, while social assistance is necessary to ensure that everyone lacking sufficient resources can live a life in dignity, this should be a last resort, enabling and supporting people to get back into an active role society. Improving the design of tax and benefits systems, fostering equal opportunities in education and training, ensuring access to quality social services and healthcare, and promoting gender equality, can contribute to reduce inequalities and poverty, as well as their transmission across generations.

[16] Everyone lacking sufficient resources has the right to adequate minimum income benefits ensuring a life in dignity at all stages of life, and effective access to enabling goods and services. For those who can work, minimum income benefits should be combined with incentives to (re)integrate into the labour market.

The emergence of new forms of work calls for an adaptation of labour market institutions. Needs for flexibility to accommodate changing labour demand have to be balanced with workers' and their families' need for security, in order to avoid labour market segmentation.. For instance, Lithuania introduced a comprehensive reform of its Labour Code, aiming at streamlining rules for termination of employment while reducing the maximum duration of fixed-term contracts, increasing unemployment benefits and encouraging collective bargaining.

Demographic ageing entails a decline in the supply of labour, putting pressure on the active population in order to ensure the sustainability and adequacy of pension systems. In the next few years, large cohorts are set to retire. In this perspective, enhancing labour market participation and productivity is crucial. There is significant scope for increasing the employment rates of women, older workers, low-skilled workers, people with disabilities and people with a migrant background. The employment of people from these groups needs to be facilitated, including by reducing disincentives to work, providing tailor-made education and training, allowing flexible working time arrangements and ensuring access to affordable and quality healthcare, childcare and other care services. Measures to promote flexible working time arrangements or access to care services have been taken, among others, by the Czech Republic, Luxembourg, Romania and Slovakia. Germany and Austria promote longer working lives by allowing flexible transitions of older workers into retirement. A number of countries took measures to promote the integration in the labour market of people with a migrant background, including Germany, Denmark, Finland and Sweden.

Workers' skills should be up to date with the needs of the labour market throughout their working life. Basic skills of young Europeans have been weakening in several Member States, and access to education is often unequal. Education systems need to be further modernised and made more open to disadvantaged groups, to allow individuals become active citizens and make the most of their working lives, and aligned with labour market needs. Efforts to upgrade education systems at all stages have to be taken up broadly to provide perspectives for young and older people alike. Together with continuous upskilling and reskilling, this would prevent the emergence of skills shortages and mismatches that are hurting small and medium-sized enterprises in particular. Some Member States started to confront the challenge. In Ireland, public spending on education is returning to pre-crisis levels and the education system is being strengthened. In Denmark, broad education reforms are aimed at improving school outcomes and raising academic standards. Croatia is rolling out a pilot scheme on the digital transformation of schools. In addition to previous measures taken in past years, Portugal recently introduced a programme to strengthen the skills and qualifications of the adult population.

Box 2: Empowering workers through better skills in Europe

In the European Pillar of Social Rights, several principles, notably principle 1[17], underline the importance of access to education, training and lifelong learning. Europe depends critically on the skills of its workforce. Education and training are drivers of growth, jobs and resilience. Europe is on track towards reaching the 2020 targets on both early school leaving and tertiary education attainment, and Member States are taking action to modernise their education and training systems to also tackle low proficiency in basic skills, improve the labour market relevance of vocational education and training and higher education, expand and increase the quality of apprenticeships, and validate the skills acquired outside the formal system. In line with the Council Recommendation on Upskilling Pathways Member States are expected to outline appropriate measures by mid-2018; the Commission suggests this is done as part of the National Reform Programmes expected this Spring and will take stock in the framework of existing reporting procedures.[18]

However, many challenges persist. Employers have difficulty finding people with the rights skills. Low-skilled or low-qualified people are at risk of unemployment, poverty, poorer health, social exclusion and democratic participation. Only half of them work, against 80% of the highly-qualified, thus weighing on labour supply and productivity. A disadvantaged socio-economic background remains the most significant factor associated with low educational achievement. Technological change and demographic ageing require investment in re- and up-skilling, but only one in ten adults engages in learning opportunities and many do not develop the skills necessary to benefit from the digital transformation. This is why the first principle of the European Pillar of Social Rights promotes access to high-quality education and training in a lifelong learning perspective, enabling people to participate fully in society.

To pursue this principle the full implementation of the New Skills Agenda launched in 2016 is key. Its ten actions tackle the main challenges, by promoting the acquisition of basic skills by low qualified adults (the 'Upskilling Pathways' initiative), fostering investment in digital skills (National Coalitions for Digital Skills and Jobs), reducing the mismatch between the skills taught and the skills needed by the service sector and manufacturing industry (Blueprint for sectoral cooperation on skills), improving the transparency of skills and qualifications (the European Qualifications Framework, Europass), modernising vocational education and training while increasing its attractiveness and addressing "brain drain" across the EU as well as boosting key competences of European citizens. The Commission will continue the collaboration with OECD in 2018 in support of skills strategies in the respective Member States and in relation to various actions focusing on vocational education and training with a view to concrete labour market skills needs. In November 2017, the Commission specified the perspective of a European Education Area, in which strengthened cross-border cooperation and enhanced mobility will help improve the quality of teaching and learning, boosting young people's skills and making them more employable. The Commission also presented an action plan on digital education on 17 January 2018.

[17] Everyone has the right to quality and inclusive education, training and life-long learning in order to maintain and acquire skills that enable them to participate fully in society and manage successfully transitions in the labour market.

[18] Council Recommendation of 19 December 2016 on Upskilling Pathways: New Opportunities for Adults (OJ C 484, 24.12.2016)

4.3 Quality investment, enhanced productivity, competitiveness

With favourable financing conditions and a brighter economic sentiment, partly due to the removal of barriers to investment, investment is picking up. Conditions for investment have improved lately, with declining uncertainty, receding corporate deleveraging pressures, supportive financing conditions, and an improved outlook on aggregate demand. At the same time, overall investment and public investment in particular still account for a relatively low proportion of GDP. Investment in intangible assets is growing, from low levels.

The removal of structural barriers to investment, in line with the Investment Plan for Europe, is being addressed. The 'third pillar' of the Investment Plan promotes the removal of barriers to investment and greater regulatory predictability in order to keep Europe attractive for investments. In order to increase the competitiveness of the European economies, enhancing product market reforms and reforms fostering innovation is crucial. Though reduced lately, high costs of regulation and administrative burdens constrain the business environment. Institutional shortcomings to be addressed include inefficiencies in public administration, regulatory burdens, corruption, as well as the challenges to the rule of law and to the effectiveness of justice systems. Competition in the services sector continues to improve, allowing grasping the benefits of digitisation, more efficient value chains, better choice, and lower prices. Finland, in particular, made substantial progress on improving the regulatory framework and reducing the administrative burden to further improve competition in services, including progress on the framework governing collaborative economy service providers. In Slovakia, a package of measures to improve the business environment and boost investment has been adopted and is to be implemented by 2019, and France in turn acted by decreasing the high tax burden on companies.

Weaknesses in administrative capacity add to the shortcomings of the business environment. The public procurement framework is being improved in Spain, Hungary and Romania. Portugal took measures to improve the functioning of efficiency of insolvency and tax proceedings. Cyprus and the Czech Republic are progressing with rolling out e-government services and Slovenia adopted the rules that are expected to speed up the construction application procedure and strengthen the legal certainty of investors, thus providing more incentives to invest.

Corruption remains an obstacle for growth in parts of Europe, creating uncertainty for businesses, slowing administrative processes and imposing additional costs for society and the economy. 37% of companies across the EU cite corruption as a problem when doing business, the issue being particularly acute in some Member States.[19] At national level, some action has been taken to address these challenges. Italy made efforts to improve its public administration and adopted important anti-corruption legislation. Spain also made progress in implementing the transparency and anti-corruption framework. New legislation on whistle-blower protection has been adopted in both Lithuania and Italy and is under consideration in several Member States.

Access to finance, especially for the small and medium-sized enterprises, is gradually improving across the Europe. Funding other than by banks plays a major role for start-ups and the scale-up of successful firms. Venture and scale-up funding are still only emerging in smaller countries or even outside financial centres in larger countries. Actions taken by

[19] All Member States are subject to ongoing assessment of their anti-corruption general policy landscape and anti-corruption efforts. The Commission has analysed the key challenges in the country reports for several Member States, where there are particularly significant risks and gaps that act as obstacles for investment, efficient resource allocation, economic performance and growth.

Portugal to improve access to capital, such as introduction of new financial instruments, serve as a good example of support to such efforts. By the same token, Slovenia is offering new financial measures to SMEs to improve their access to alternative financing sources. Cyprus is implementing the action plan for growth including the framework to attract and facilitate large-scale investments.

Positive examples to support productivity growth need to be followed. Encouraging measures taken across Member States respond to challenges which are, at least to some extent, country-specific. Luxembourg strengthened the diversification of its economy, including by removing barriers to investment and innovation. In Belgium, numerous activities are fostering investment in knowledge-based capital, in particular with measures to increase digital technologies adoption, and innovation diffusion. Spain took first steps to improve the governance of its research and innovation system. Denmark introduced a programme to increase productivity and improve the business environment and Poland and Latvia introduced tax cuts to encourage investment. In Germany, a network of competence centres supports the digitisation of small and medium-sized businesses and 'digital hubs' facilitate the cooperation between start-ups, SMEs, industry, science and administration. To support the start-up ecosystem the Estonian government has introduced a new visa programme for non-EU entrepreneurs who wish to establish their start-up company in the country. In the Netherlands, a number of measures are fostering the uptake of the circular economy, including through public procurement.

5. NEXT STEPS

The European Semester offers the opportunity of a constant dialogue between the Commission, Member States, social partners and stakeholders at all levels throughout the year. The country reports published today draw on in-depth exchanges with governments, national authorities and stakeholders at both technical and political level, including high-level bilateral meetings held in December 2017. Their findings will be presented in the Commission's representation offices in the capitals of the Member States, and followed up in bilateral meetings as well. Commission Vice-Presidents and Commissioners will visit Member States to seek the views of social partners, parliaments, governments and other stakeholders on the analysis in the country reports. The Commission will discuss the summary findings of the country reports with the European Parliament.

The next step is for Member States, in the light of the challenges identified, to present their economic and social priorities in their national reform programmes by mid-April. To provide an adequate and sustainable response to the challenges, the Commission recommends that these programmes are drawn up with the support of all key stakeholders, such as social partners, regional and local authorities, and civil society organisations as appropriate.

APPENDIX 1 – INTEGRATED SURVEILLANCE OF MACROECONOMIC AND FISCAL IMBALANCES

	Macroeconomic Imbalances Procedure (MIP)[20]	Stability and Growth Pact (MTO: medium term objective / EDP: excessive deficit procedure)	Comments
AT		Preventive arm Not yet at MTO; subject to debt rule[21]	
BE		Preventive arm Not yet at MTO; subject to debt rule	
BG	Imbalances	Preventive arm Overachieving MTO	
CY	Excessive imbalances	Preventive arm At MTO; subject to transitional debt rule	
CZ		Preventive arm Overachieving MTO	
DE	Imbalances	Preventive arm Overachieving MTO; subject to debt rule	
DK		Preventive arm AT MTO	
EE		Preventive arm Not yet at MTO	
EL			Under a dedicated financial assistance programme
IE	Imbalances	Preventive arm At MTO; subject to transitional debt rule	
ES	Imbalances	Corrective arm Excessive deficit, deadline for correction: 2018	
FR	Imbalances	Corrective arm Excessive deficit, deadline for correction: 2017 Not yet at MTO; subject to transitional debt rule [22]	

[20] Both the 'imbalances' and 'excessive imbalances' categories entail specific monitoring, to be modulated depending on the severity of the challenges.

[21] Debt rule: If the 60% reference for the debt-to-GDP ratio is not respected, the Member State concerned will be put in the Excessive Deficit Procedure, after taking into account all relevant factors and the impact of the economic cycle, if the gap between its debt ratio and the 60% reference is not reduced by 1/20th annually (on average over three years). Transitional debt rule: each Member State in the Excessive Deficit Procedure is granted a three-year period following the correction of the excessive deficit for meeting the debt rule. This does not mean that the debt rule does not apply during this period as Member States should make sufficient progress towards compliance during this transitional period. A negative assessment of progress made towards compliance with the debt benchmark during the transition period could lead to the opening of an Excessive Deficit Procedure.

[22] Conditioned on the abrogation of the EDP decision based on validated outturn budgetary data for 2017.

HR	Excessive imbalances	Preventive arm Not yet at MTO; subject to debt rule	
HU		Preventive arm Not yet at MTO; subject to debt rule	
IT	Excessive imbalances	Preventive arm Not yet at MTO; subject to debt rule	
LT		Preventive arm At MTO	
LU		Preventive arm Overachieving MTO	
LV		Preventive arm Not yet at MTO	
MT		Preventive arm At MTO	
NL	Imbalances	Preventive arm Overachieving MTO	
PL		Preventive arm Not yet at MTO	
PT	Imbalances	Preventive arm Not yet at MTO; subject to transitional debt rule	
SI		Preventive arm Not yet at MTO; subject to transitional debt rule	
SE	Imbalances	Preventive arm Overachieving MTO	
SK		Preventive arm Not yet at MTO	
RO		Preventive arm Subject to significant deviation procedure	
FI		Preventive arm Not yet at MTO; subject to debt rule	
UK		Preventive arm Not yet at MTO; subject to transitional debt rule	

(*) The Recommendations under the '2-pack' (Reg. No 473/2013) regarding measures to be taken in order to ensure a timely correction of its excessive government deficit only concern euro area Member States.

APPENDIX 2 – PROGRESS TOWARDS EUROPE 2020 TARGETS

Europe 2020 targets for the EU	2010 data	Latest available data	In 2020, based on recent trends
1. Increasing the employment rate of the population aged 20-64 to at least 75%	68.6%	72.3% (Q3-2017)	Target likely to be met
2. Increasing combined public and private investment in R&D to 3% of GDP	1.93%	2.03% (2016)	Target unlikely to be met
3a. Reducing greenhouse gas emissions by at least 20% compared to 1990 levels	14% reduction	23% reduction (2016)	Target likely to be met
3b. Increasing the share of renewable energy in final energy consumption to 20%	12.5%	17.04 (2016)	Target likely to be met
3c. Moving towards a 20 % target in energy efficiency	5.7% (for primary energy consumption)	16.0% (2016) (for primary energy consumption)	Target likely to be met
4a. Reducing school drop-out rates to less than 10%	13.9%	10.7% (2016)	Target likely to be met
4b. Increasing the share of the population aged 30-34 having completed tertiary education to at least 40%	33.8%	39.1% (2016)	Target likely to be met
5. Lifting at least 20 million people out of the risk of poverty and social exclusion	0.5 million increase (compared to the 2008 base year)	1 million increase (compared to the 2008 base year)	Target unlikely to be met

APPENDIX 3 – 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, in a context of incomplete labour market adjustment. Meanwhile, the net external position has improved, mainly due to the current account surplus. The authorities have made progress in implementing the recommendations addressed after the asset quality and balance sheet reviews, but the legacy issues linked to weak governance, asset quality and supervision have not yet been fully dealt with. 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 high. Labour market improvement has continued despite persistent structural issues, such as the high share of young people not in employment, education or training and labour shortages and mismatches. Some measures have been taken to tackle the main sources of imbalances, but further progress is needed to address remaining vulnerabilities in the financial sector, including further improving banking and non-banking supervision, dealing with hard-to-value assets and group level supervision, and completing the reform of the insolvency framework.

Croatia is experiencing excessive imbalances. Vulnerabilities are linked to high levels of public, private and external debt, all largely denominated in foreign currency, in a context of low potential growth. Strong growth, above its estimated potential, is helping to reduce stock imbalances: public, private and external debt ratios are declining at a fast pace. The negative net external position remains large, but has been improving due to a current account surplus. Strong growth supported further debt reduction, and the pace of deleveraging is set to slow down, as credit flows to households and corporates turn positive. Government debt peaked in 2014, and is currently on a declining path, driven by both strong GDP growth and a reduction in the headline deficit. The banking sector is increasingly profitable and the stock of non-performing loans continued to decline. Still, the foreign currency exposure (mainly euro) of corporations and households remains a source of vulnerability. While the economic environment is improving, there has been little advancement in the adoption of policy measures aimed at addressing macroeconomic imbalances, including by raising the still low growth potential.

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 is still negative and widening, and is not adequate to guarantee a sustainable evolution of the large net external liabilities stock. Private debt is only slowly decreasing, and credit flows to the private sector are picking up despite very high levels of private debt. Loan restructuring efforts by banks, the strong cyclical upturn, and the implementation of past reforms have allowed a reduction of non-performing loans, but their stock remains very high. Poor contract enforcement, inefficiencies in the judicial system, bottlenecks in the implementation of the foreclosure and insolvency legislation as well as weak repayment discipline hamper private sector deleveraging and the reduction of non-performing loans. A prudent fiscal stance and an active debt management policy accelerated public debt reduction. Renewed reform momentum is needed, notably to help reduce public debt, improve competitiveness, accelerate the reduction of non-performing loans and raise potential growth.

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. Moderate wage growth supports on-going improvements in cost competitiveness.

Subdued productivity growth is instead acting as a headwind. Labour market's low responsiveness to changing demand and supply conditions and some elements of the business environment still weigh on non-cost competitiveness. The government debt-to-GDP ratio rose further in 2017, but it is forecast to stabilise in 2018 and 2019. Previously adverse trends have thus abated, economic conditions are improving and reform efforts are gaining momentum. Recently announced and undertaken policy actions can carry both domestic and cross-border positive effects in the medium term. Progress on several fronts including labour markets and taxation has been achieved, while announced initiatives to improve the business environment, vocational education and training, unemployment benefit, and pension systems have still to materialise. Further action is warranted for ensuring a better access to the labour market for the jobseekers, simplifying the tax system and reviewing government expenditure to ensure sustainability of public finances and enhance growth potential.

Germany is experiencing imbalances. The persistently high current account surplus has cross-border relevance and reflects a subdued level of investment relative to saving in both the private and the public sector. The surplus, which is largely with non-EU countries, has slightly narrowed since 2016 and is expected to gradually decline due to a pick-up in domestic demand in the coming years whilst remaining at historically high levels over the forecast horizon. While there is currently a shift towards more domestic demand-driven growth, both consumption and investment remain muted as a share of GDP despite the favourable cyclical and financing conditions and the infrastructure investment needs for which there is fiscal space. While a number of measures have been taken to strengthen public investment, these efforts have not yet resulted in a sustainable upward trend in public investment as a share of GDP. Progress in addressing recommendations in other areas has also been limited.

Ireland is experiencing imbalances. Large stocks of private and public debt and net external liabilities constitute vulnerabilities. However, the improvements have been substantial. Strong productivity growth in past years has implied improved competitiveness and a positive current account balance entailing a rapid reduction in the high stock of net foreign liabilities. Strong economic growth continues to support private deleveraging but the stock of private debt remains high, although the strong influence of the activities of multinational enterprises needs to be taken into account when evaluating corporate debt, and household debt appears broadly in line with fundamentals. Government debt is projected to remain on a downward trajectory, and the deficit is moving closer to balance. House prices are growing at a rapid pace, albeit from likely undervalued levels, thereby also strengthening households' balance sheets. Banks are well recapitalised and their profitability is improving gradually. The stock of NPLs, although remaining high, continues to decrease. Policy action addressing these vulnerabilities has been taken, but some measures will take time to generate the expected effects.

Italy is experiencing excessive imbalances. High government debt and protracted weak productivity dynamics imply risks with cross-border relevance looking forward, in a context of still high level of non-performing loans and unemployment. The government debt ratio is set to stabilise but has not yet embarked on a firm downward path due to the worsening of the structural primary balance. External competitiveness has improved, but weak productivity growth, linked to structural obstacles which continue to hamper an efficient allocation of productive factors across the economy, accelerating unit labour costs and the general low inflation environment are making it challenging to reverse past large competitiveness losses. Market pressures on the banking sector have abated, following, among other measures, the government's support for capitalisation of a few distressed banks. The stock of non-performing loans has only recently started to decrease, and still weighs on banks' capital needs, profits, and lending policies. The reform momentum has somehow slowed, but some progress has been made in addressing recommendations. Several measures are now in the

pipeline, notably in the fields of labour and social policies, civil justice and business environment.

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 large current account surplus, which mainly reflects structural features of the economy and policy settings regarding non-financial corporations and is partly explained by deleveraging pressures, has increased recently but is forecast to decline somewhat. The private debt-to-GDP ratio has only very gradually decreased in the last years, supported by economic growth. At the same time, nominal household debt is increasing again, as the ongoing recovery in the housing market is driving up nominal mortgage debt levels. Recent reform announcements, such as the speeding-up of the reduction of mortgage interest deductibility and the fiscal stimulus should 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. A prudent current account position and the maintenance of competitiveness gains are required to ensure the adjustment of net external liabilities. Private debt ratios continue to decline from high levels due to both resumed nominal growth and slightly negative credit flows, and the government debt-to-GDP ratio is projected to have entered a decreasing trend, in a context of persistent deleveraging needs. Financial sector interventions contributed to reduce stability risks, although banks remain penalised by low profitability and a large stock of non-performing loans, which have nonetheless started declining. Higher productivity growth is key for improved prospects in competitiveness, deleveraging and potential growth. Unemployment has been decreasing at a strong pace for several years. Policy gaps remain, notably in terms of implementing the measures outlined to reduce non-performing loans and to improve the business environment. The adoption and implementation of several reform plans, including measures to tackle labour market segmentation or fiscal-structural reforms to improve the sustainability of public finances, will need to be monitored.

Slovenia is experiencing no imbalances. Risks arising from weaknesses in the banking sector, corporate indebtedness and short-term fiscal situation have receded. Government debt has peaked in 2015 and has been on a downward trend since then. The corporate sector underwent a substantial deleveraging, which weakened investment and potential growth. However, investment is now accelerating, and foreign direct investment inflows have recovered considerably in the most recent years. Banking sector restructuring has coincided with a rapidly falling share of non-performing loans. Policy action which contributed to the unwinding of imbalances has been taken, but measures to enhance the sustainability of the pension, health care and long-term care systems remain a key priority.

Spain is experiencing imbalances. Large stocks of external and internal debt, both public and private, continue to constitute vulnerabilities in a context of high unemployment and have cross-border relevance. The external rebalancing is advancing, thanks to the current account surpluses recorded since 2013. However, net external liabilities remain high and Spain will have to record sustained current account surpluses for an extended period of time before the net external liabilities reach prudent levels. Private sector debt reduction is also progressing, supported by favourable growth conditions, but deleveraging needs are still present. A healthier financial sector supports economic activity, and the non-performing loans ratio decreased further. Despite the strong nominal GDP growth, government debt as a share of GDP has only just begun to slowly decrease, with deficits forecast to narrow over time. Unemployment has continued its rapid decline, but remains very high and the high degree of

labour market segmentation impedes faster labour productivity growth. Policy progress has been especially made between 2012 and 2015, and recently only limited progress has been made in addressing recommendations. Challenges remain, in particular concerning fiscal governance, active labour market policies and improving innovation and skills to boost non-cost competiveness.

Sweden is experiencing imbalances. Overvalued house price levels coupled with a continued rise in household debt poses risks of a disorderly correction. The already high household debt remains on an upward path. House prices have been growing at fast and virtually uninterrupted pace for about 20 years. Negative growth has been recorded in the last quarter of 2017. Still, valuation indicators suggest that house prices remain very high relative to fundamentals. Although banks appear adequately capitalised, a disorderly correction could also affect the financial sector as banks have a growing exposure to household mortgages. In such a case, there could be spill-overs to neighbouring countries given the systemic financial interlinkages. Awareness of mounting risks among the authorities is high, and in recent years measures have been taken to rein in mortgage debt growth and raise housing construction. However, policy steps implemented so far have not been sufficient to address overvaluation in the housing sector, and key policy gaps remain, particularly in relation to tax incentives for home ownership as well as the functioning of housing supply and the rental market.