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Directorate-General for Economic and Financial Affairs

Alert Mechanism Report

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EUROPEAN ECONOMY

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EXECUTIVE SUMMARY

The Alert Mechanism Report (AMR) identifies Member States that the Commission considers may be affected by, or may be at risk of being affected by, imbalances, based on an economic reading of the Macroeconomic Imbalance Procedure scoreboard°([1]). The reading considers the outturn data for 2022, which are interpreted in a forward-looking manner, taking into account the development of possible risks based on 2023 in-year economic developments and longer-term forecasts from the Commission 2023 autumn forecast, where relevant. This paper contains the analysis included in the Commission staff working document as well as the content of the accompanying Commission Communication, which together make up the Alert Mechanism Report 2024°([2]).

The Alert Mechanism Report 2024 considers the evolution of macroeconomic imbalances at a time of still high but declining inflation and weak economic growth. By early 2023, the peak in headline inflation appeared to have been reached in most EU economies, as energy prices have fallen and continuing reductions in food inflation are easing price pressures. Despite substantial falls, as reflected in the most recent data, a stickiness in core items may make it difficult for inflation to ease to a more desirable level in the immediate future. A protracted period of elevated inflation exacerbates the risk of continued divergence as national economies adjust and redistribute the impact of the energy price shock in different ways. Growth has stuttered in real terms in many countries, particularly around the turn of the year, with muted consumption stemming from reduced real household purchasing power and monetary tightening dampening demand. The current outlook is for further, albeit slower, reductions in inflation rates and a gradual pick-up in real GDP growth. Risks to the outlook are driven by the global context: the new conflict in the Middle East, Russia's continued war against Ukraine, and a generally changing geopolitical context, which may impinge on global trade and make external conditions difficult. Across the globe, inflation and central banks' responses to tackling inflationary pressures, in combination with the appreciation of the US dollar, have led to some financial stress outside the EU.

Sector-specific thematic reading

- In 2022, **current account balances declined in almost all Member States**, but are increasing in most cases in 2023. The impact of soaring energy prices **reduced surpluses and widened deficits**. Both energy and non-energy balances declined, reflecting worsening terms of trade as well as still strong, albeit weakening, domestic demand and exchange rate depreciations in some countries. High current account surpluses narrowed somewhat in 2022. The current account balances of most large net-debtor countries remained below the levels conducive for their swift correction. The large **net external stock positions**, both positive and negative, generally narrowed but remained substantial. Throughout 2023, external balances have been making a partial return to their previous levels, owing mainly to lower energy prices and weakening demand. While many moderate current account deficits are closing, a small

([1]) Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances.

([2]) Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, Alert Mechanism Report 2024, COM(2023) 902 and Commission staff working document, Alert Mechanism Report 2024, SWD(2023) 901

number of countries continue to have much higher deficits than before either 2022 or the COVID-19 crisis. Moreover, these deficits remain higher than what fundamentals would suggest or what an improvement in their external stock position towards more prudent levels would call for. The current accounts of most large net-debtor countries are increasing as the impact of energy prices wanes.

- In 2022, the **euro area current account** balance fell significantly, turning negative for the first time in more than a decade as a result of the much higher energy prices, but has been increasing ever since. With the deterioration in the terms of trade, the nominal trade balance fell sharply as imports values grew much faster than exports, while the trade balance remained broadly stable in real terms. With an improvement in the terms of trade underway and muted real demand, the euro area current account started to strengthen in late 2022 and returned to a surplus in the second quarter of 2023. It is forecast to continue improving this year and next, with a strengthening trade balance. Overall, the narrowing of the net international investment positions has led to some rebalancing of **external positions within the euro area**; the changes in these positions have been greater for net-debtor countries despite some sizeable reductions in their current accounts.

- Growth in **unit labour costs** picked up markedly overall and diverged considerably between countries in 2022 and into 2023 – including within the euro area, where divergence poses higher competitiveness risks. Very strong growth in some Member States marks a sharp acceleration relative to recent years. Wage increases were substantial in most countries, but were still below the increases in the cost of living. This resulted in pressure on household budgets, especially for low-income earners. In 2023, wages have been accelerating. As a result, unit labour costs are forecast to rise even faster in 2023 than in 2022 in most countries, and even where they moderate, they are still expected to grow at a strong pace. Cumulatively, wages are forecast to fall in real terms over 2022 and 2023. For 2024, the forecast is for a significant slowdown in unit labour costs growth rates, but uncertainty remains high as wages are dependent on negotiations that have not yet taken place in many countries. The expected stronger growth in unit labour costs in some net-creditor countries should support further symmetric rebalancing of the external positions within the euro area in 2023 and 2024.

- The nominal depreciation of the euro against other major currencies in 2022 – as Europe was more directly affected by the energy crisis and monetary conditions remained looser – resulted in an overall depreciation of the euro area's **real effective exchange rate**. The euro gained strength in the first half of 2023. Within the euro area, high inflation countries have shown a continued appreciation of their real effective exchange rates, mainly driven by differentials in core inflation. Outside the euro area, changes in the nominal exchange rate have been a significant factor affecting real effective exchange rates, and in most countries a nominal depreciation in 2022 was followed by some appreciation in the course of 2023, even relative to the euro. Overall, the monetary stance tightened more and earlier in non-euro area countries, particularly at the very beginning of the inflationary period. However, in those countries, and despite the clear reduction in headline inflation since the turn of this year, price pressures remain high.

- **Corporate debt-to-GDP** ratios decreased in 2022, reflecting strong nominal GDP growth. Loan flows were strong for most of 2022, but started to decelerate sharply towards the end of the year. Profits increased overall as firms benefited from higher pricing power. However, unit profit growth recently decelerated, with industry particularly affected. By 2023, active deleveraging was present in some countries as loan flows turned negative. However, debt stocks remain sizeable in many Member States and above pre-pandemic levels in some cases and represent a risk factor. As corporate loans are typically taken out with flexible conditions and short maturities, rising interest burdens increase pressures in some sectors, including commercial real

estate. In some countries, non-performing loans and business bankruptcies have started to increase and are clustered in high-risk sectors, including accommodation and food and transport. In the near future, rising interest rate burdens, declining profits, potential cost competitiveness pressures and limited access to financing are likely to increase corporate vulnerabilities. The reduced recourse to new loans will also likely hamper corporate investment, affecting growth prospects in the future.

- **House prices** continued to accelerate in most Member States in the early months of 2022, before reaching a turning point. A combination of higher mortgage rates and lower real disposable incomes led to a slowing of house price increases, with house prices falling on a quarterly or even annual basis in the most affected countries, leading to a reduction in overvaluations. House prices are expected to continue adjusting to higher interest rates. In a handful of countries, however, where mortgage rates have not increased substantially or where financing is flowing in from abroad, house prices continue to experience strong growth and construction activity is strong.

- **Household debt ratios** continued to fall in 2022, despite buoyant mortgage flows over the early months of the year. Household debt is decreasing further in 2023 due to reduced mortgage flows, and there is a weaker denominator effect than in 2022 as real GDP growth is slowing and inflation easing. Despite these continued reductions in debt ratios, the interest burden on some households has increased and will continue to do so in many countries as higher interest rates gradually feed through into monthly mortgage payments. The extent and speed of this depends on how long mortgage rates are fixed for and the share of interest payments in monthly payments. Across the EU, mortgage rates increased significantly over the course of 2022, exceeding levels observed over the last decade. In a few countries, they have peaked recently, but in most, the cost of borrowing was still rising in September 2023.

- **Government debt** fell as a share of GDP in 2022, with nominal growth having a strong denominator effect, and further reductions are underway. Nominal growth also contributed to buoyant tax revenues with government deficits falling. While support measures to mitigate the impact of higher energy prices weighed on the deficit, they typically replaced the sizeable pandemic support packages. Government debt-to-GDP ratios remain higher than prior to the COVID-19 crisis in most countries, with the exceptions being primarily some very high debt countries marked by very strong real GDP growth. Over 2023 and 2024, debt levels are forecast to fall more slowly in most cases or to stall in others. The interest burden of government debt has been rising, and gross financing needs remain significant in many countries, with high inflation expected to gradually feed into higher government expenditure.

- Higher inflation and rising interest rates changed the environment for the **banking sector**, enabling it to become more profitable as interest margins increase. Overall, the banking sector is well capitalised and liquidity is sufficient. Despite the pressures on borrowers, the low level of non-performing loans has remained stable so far. The euro area banking sector has seen a temporary reduction in its valuations following bank bankruptcies in the US and Switzerland in March, but has otherwise not shown an increase in related vulnerabilities. However, the weak short-term economic outlook may affect assets and credit risks, and certain sectors such as commercial real estate are a source of potential stress. There is also uncertainty about possible hidden vulnerabilities in the financial sector, including in the non-bank financial sector. The results of the 2023 stress test conducted by the European Banking Authority and the European Central Bank point to the ability of European banks to withstand adverse outcomes and become more resilient relative to previous exercises.

Outlook for economic imbalances

Strong nominal growth has facilitated the debt deleveraging, easing some long-standing imbalances, but pressures stemming from tighter financing conditions have grown. The inflationary environment facilitated faster passive deleveraging, reducing indebtedness as long as no new stresses emerge. For countries on a deleveraging path, the current climate has favoured and should continue to favour an easing of vulnerabilities. A continued gradual reduction in debt can continue in countries with long-standing vulnerabilities provided there are no additional financing needs, but it may be more difficult where private sector loans have been taken out by overstretched households in recent years and where government financing needs are the result of short durations. In countries where debt servicing requires large rollovers of debt, and where the private sector faces fast increases in mortgage payments, increased debt servicing costs are a risk to the economy. Non-financial corporations with large debts may struggle to meet their increased financing obligations if they face additional pressures from changing economic conditions, including to their competitiveness. In some cases, the interest rates exceed or approach nominal GDP growth rates, raising the prospect of a snowball effect on government debt, which requires larger primary surpluses to be contained.

The entrenchment of deteriorations in cost competitiveness is becoming a more concrete risk as price and cost pressures continue to diverge. Cost competitiveness concerns were highlighted in last year's Alert Mechanism Report, as differentiated price and cost increases raised the prospect of real appreciation and subsequent risks of competitiveness losses in countries with strong price increases. These concerns remain, although they have abated in some cases. Some high inflation countries display signs of core inflation stickiness at a high level, and are marked by continued high increases in unit labour costs, as other countries' core rates reduce, increasing the differences in price levels. Persistent competitiveness losses could spill over into other economic developments if vulnerabilities such as pre-existing debt or stress in particularly indebted sectors are present. For euro area countries, a re-alignment of domestic costs and prices via changes in the nominal exchange rate is not an option. In addition, divergent inflationary effects make the task of the monetary authority more difficult as the uniform transmission of changes in monetary stance to all parts of the monetary union may be hampered by differences in real interest rates across the euro area, which in some cases may drive further divergence. Across the EU, countries may struggle to address strong inflation and subdued growth while remaining in sync with their peers.

The adjustment of external balances following the price shock may be challenging, particularly for countries with external deficits. A number of countries face the prospect of large current account deficits continuing into the near future either due to their high energy import dependency or to resilient domestic demand, which is often associated with loose fiscal policies. Persistently high energy prices may require an acceleration of costly structural adjustments away from high import dependency to avoid the build-up of external debt or a reduction of potential growth. Over time, external weaknesses and a rise in external indebtedness could lead to economic stress if there is an erosion of cost competitiveness and an absence of internal demand restriction. Most countries at risk of sustained competitiveness losses stemming from high inflation have some margin on the external side as their underlying starting external positions are strong. Current account surpluses that fell in 2022 are increasing again. Higher long-term energy prices would affect these countries' output. The extent to which they will affect the current accounts will depend on how demand responds. The return of euro area rebalancing depends on the relative adjustments of surplus and deficit countries as economic conditions normalise, and rebalancing is forecast to continue.

In most cases the reversal in house price dynamics reflects a soft adjustment to higher interest rates, but in other cases dynamics are more worrying, with possible spillovers into other sectors. In most cases, the modulation or reduction in house prices that is underway

can be expected to be limited to a level adjustment that reflects the higher interest rate environment, before resuming their long-term upward trajectory driven by limited housing supply. However, feedback loops into the economy are possible. These are evident in particular in some countries where higher mortgage rates have reduced household consumption when households are highly indebted. In addition, differences in the translation of interest rates into loan payments can also lead to frictions in the transmissions of monetary policy. In countries where house prices are contracting, falling prices could put pressure on banks, with reductions in their collateral eroding asset quality and affecting capitalisation as well as the credit supply to the rest of the economy. Non-financial corporations that are very active in the commercial real estate sector may be particularly affected, and the same holds for banks very exposed to the commercial real estate sector. In some countries, on the other hand, prices continue to experience strong growth, possibly tied to interest rates being too low or external funds flowing in, and a continued build-up of risks in the real estate sector could result in higher vulnerabilities and a potential sharp correction in future.

Country-specific conclusions

In 2024, In-Depth Reviews will be prepared for the 11 Member States that were identified as experiencing imbalances or excessive imbalances in 2023°([3]). The Alert Mechanism Report presents an overview of the evolution of key data underlying these imbalances. An economic assessment of whether these imbalances are aggravating, are under correction, or have been corrected, with the view to updating existing assessments and assessing possible remaining policy needs will be undertaken in the 2024 In-Depth Reviews to be published in the first half of 2024. This will be the case for **Cyprus, France, Germany, Greece, Italy, Hungary, the Netherlands, Portugal, Romania, Spain**, and **Sweden.**

In addition, the economic reading of the scoreboard leads to the conclusion that an In-Depth Review will be undertaken for Slovakia, as it presents particular risks of newly emerging imbalances. In **Slovakia**, concerns related to cost competitiveness, external accounts, government finances, house prices and household debt, persist. These concerns were analysed in an In-Depth Review in spring 2023, and were found to be overall contained in the near future, with the expectation that they would ease as economic conditions normalise, leading to a conclusion that no imbalances were present°([4]). The current scoreboard reading for Slovakia shows that in 2022 four indicators were beyond their indicative thresholds, namely the net international investment position, the export market share, unit labour costs, and the youth unemployment rate. The economic reading of the scoreboard points to risks of imbalances as the abatement of these risks does not appear to be clearly underway. After several years of significant increases, nominal unit labour costs are set to accelerate further, growing faster than in the euro area overall. Headline and core inflation remain well above euro area peers, and the differential is not reducing sufficiently, to undo accumulated increases in price levels. The current account deficit remains sizeable, even if declining recently owing to lower energy prices. The clearly negative net international investment position is expected to remain stable this year and slightly worsen next year; excluding non-defaultable instruments, it is now at its lowest level in two decades. The fiscal deficit is set to widen, while the government debt is expected to increase going forward as nominal GDP growth moderates and the deficit increases. Nominal house price growth turned negative recently, but prices still show signs of overvaluation. The household debt-to-GDP ratio, which had been on an upward trend over the last two decades, is expected to decline this year on the back of high inflation, while credit flows remain resilient.

([3]) Communication from the Commission 2023 European Semester - Spring Package, COM(2023) 600.

([4]) See previous footnote; see also ‘In-depth review for Slovakia’, 24 May 2023, SWD(2023) 643 final.

For the remaining Member States, there is no need to carry out In-Depth Reviews at this juncture. For those Member States that were subject to an In-Depth Review in spring 2023 but were not identified as experiencing imbalances or excessive imbalances (**Czechia**, **Estonia**, **Latvia**, **Lithuania**, and **Luxembourg**), this Alert Mechanism Report concludes that while some developments may be of concern, associated risks of imbalances are reducing with the normalisation of economic conditions.

For **four** other Member States, the economic reading of the scoreboard leads to the conclusion that while they are not as affected by, or at risk of being affected by, imbalances, a number of developments or concerns merit attention. In **Bulgaria**, developments related to cost competitiveness, dynamic household borrowing and strong house price growth are of relevance. Nominal unit labour costs are expected to continue growing sharply, while core inflation has been well above the euro area average. Nominal house price growth has moderated recently but remains high, and household borrowing is sustained while household debt is contained. A strong underlying external position and the ongoing nominal convergence process mitigate risks. In **Croatia**, cost competitiveness pressures have recently increased and house prices have grown strongly. While nominal unit labour costs have increased visibly substantial differentials with respect to the euro area are very recent, mitigating risks. Government debt, while high, is continuing to decline and is forecast to come in below 60% of GDP by the end of next year. Nominal house price growth remains high as prices continue to rise strongly. In **Denmark**, the large current account surplus has increased further and non-financial corporations and household debts are very high. The current account surplus is the highest in the EU and has increased over the last decade and jumped further in 2022. While moderating, the surplus is forecast to remain very high, but there are limited spillover risks and Denmark's economic fundamentals remain strong. In **Poland**, developments related to unit labour costs and the widening high fiscal deficit are of increasing relevance. Nominal unit labour costs increased visibly last year, and are expected to grow more markedly this year, and both headline and core inflation have been above euro area and EU averages. The fiscal deficit widened last year and is forecast to further increase substantially in 2023, but the external position continues to strengthen and is no longer past the scoreboard threshold, mitigating risks.

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

The number of Member States recording scoreboard variables beyond relevant thresholds in a certain year is based on the vintage of the scoreboard published with the respective annual Alert Mechanism Report. EU27 and EA20 aggregates added where beyond threshold. Possible ex-post data revisions may imply a difference in the number of values beyond thresholds computed using the latest figures for the scoreboard variables compared with the number reported in the graph above; for instance, the increase in the number of Member States with current account readings outside the thresholds between 2019 and 2020 data observed in the graph above is mostly due to data revisions. Forecasts for financial sector liabilities are performed for 2023 only; no forecasts are performed for long-term unemployment and youth unemployment.
Source: Eurostat and Commission calculations

Graph B: **AMR scoreboard indicators in 2022, by country**

Scoreboard	Current account	NIIP	REER	Export market shares	Nominal ULC	House prices	Private credit flow	Private sector debt	Government debt	Financial sector liabilities	Unemp.	L-T Unemp.	Activity rate	Youth unemp.
Belgium	0.6%	57.7%	1.7%	-1.9%	10.1%	-3.8%	5.7%	161.4%	104.3%	-2.7%	5.9%	0.2%	1.4%	1.9%
Bulgaria	-1.0%	-12.9%	5.8%	15.5%	23.6%	-2.1%	5.9%	74.6%	22.6%	12.0%	5.2%	-0.6%	0.5%	-1.4%
Czechia	-2.3%	-19.7%	13.7%	-7.7%	14.8%	1.6%	4.5%	76.1%	44.2%	3.2%	2.5%	0.0%	0.5%	1.2%
Denmark	10.2%	58.2%	-1.2%	12.4%	7.2%	-7.4%	13.1%	188%	29.8%	-1.6%	5.1%	-0.3%	1.3%	0.5%
Germany	6.3%	70.2%	-0.5%	-13.0%	7.2%	-1.3%	6.7%	118.4%	66.1%	1.5%	3.5%	-0.2%	1.4%	-0.2%
Estonia	-2.6%	-20.2%	8.8%	17.0%	19.0%	4.5%	9.2%	94.3%	18.5%	1.6%	6.2%	0.4%	2.0%	7.0%
Ireland	6.0%	-116.8%	-4.6%	32.1%	-10.6%	5.0%	2.0%	147.1%	44.4%	-4.0%	5.5%	-0.3%	3.5%	-2.4%
Greece	-7.9%	-144.2%	-2.5%	12.6%	3.5%	4.4%	1.1%	100.8%	172.6%	-0.5%	14.9%	-3.6%	0.9%	-6.1%
Spain	0.7%	-60.2%	-0.7%	-7.8%	10.8%	0.8%	0.3%	123.5%	111.6%	-4.5%	14.4%	-0.3%	0.2%	-2.7%
France	-1.1%	-23.8%	-3.8%	-10.7%	11.1%	1.5%	8.7%	163.9%	111.8%	-1.3%	7.7%	-0.3%	1.0%	-3.4%
Croatia	-0.9%	-25.4%	-0.6%	12.1%	11.0%	3.2%	6.0%	79.3%	68.2%	9.5%	7.4%	0.0%	3.4%	1.4%
Italy	1.6%	4.7%	-1.9%	-8.4%	4.9%	-3.2%	2.9%	105.5%	141.7%	-5.7%	9.0%	-1.3%	-0.2%	-5.5%
Cyprus	-8.0%	-96.2%	-3.0%	20.7%	-1.2%	-3.1%	-3.9%	213.4%	85.6%	-2.3%	7.3%	0.2%	2.2%	2.0%
Latvia	-1.9%	-26.5%	5.7%	15.3%	16.7%	-1.0%	3.0%	52.5%	41%	4.1%	7.5%	-0.7%	-0.5%	2.6%
Lithuania	1.0%	-7.0%	9.8%	28.8%	27.7%	0.4%	6.8%	51.4%	38.1%	1.0%	7.2%	0.4%	0.6%	0.0%
Luxembourg	8.0%	47%	-0.5%	-0.8%	13.2%	4.0%	-19.5%	325.5%	24.7%	-4.9%	5.6%	0.0%	1.5%	0.6%
Hungary	-4.5%	-50.8%	-8.1%	-3.5%	23.1%	5.1%	9.2%	78.8%	73.9%	8.6%	3.9%	0.1%	2.5%	-0.6%
Malta	0.1%	78.8%	-3.1%	2.7%	8.6%	1.2%	6.4%	121.8%	52.3%	5.9%	3.6%	0.1%	4.1%	-1.0%
Netherlands	8.8%	75.2%	3.2%	-0.1%	9.8%	6.1%	6.9%	210.1%	50.1%	-3.7%	4.2%	-0.2%	1.3%	-0.9%
Austria	1.6%	17.6%	0.1%	-4.7%	10.7%	3.7%	5.0%	121.9%	78.4%	-3.0%	5.7%	-0.2%	0.5%	0.4%
Poland	-0.4%	-33.4%	-0.2%	16.6%	16.9%	-1.9%	1.9%	63.5%	49.3%	3.0%	3.2%	0.2%	3.6%	0.9%
Portugal	-1.0%	-83.6%	-2.9%	-1.9%	10.7%	4.8%	2.9%	141.1%	112.4%	-4.0%	6.5%	-0.1%	1.5%	0.7%
Romania	-7.1%	-40.6%	2.6%	6.7%	10.4%	-6.2%	3.3%	43.3%	47.2%	8.2%	5.8%	0.2%	3.5%	1.8%
Slovenia	3.2%	-1.5%	-1.3%	2.9%	14.3%	4.3%	5.2%	66.0%	72.3%	-1.4%	4.6%	-0.3%	1.6%	2.0%
Slovakia	-3.6%	-61%	3.8%	-6.6%	13.3%	1.3%	9.3%	92.7%	57.8%	-9.3%	6.5%	0.2%	1.4%	2.8%
Finland	-0.5%	-1.7%	-3.1%	-2.0%	8.6%	-4.6%	2.3%	144.7%	73.3%	1.7%	7.4%	0.0%	2.5%	-3.5%
Sweden	5.8%	34.8%	-1.4%	-2.7%	5.8%	-3.1%	10.6%	207.3%	32.9%	3.7%	8.3%	0.4%	1.0%	2.3%

Source: Eurostat and Commission calculations (See Statistical Annex, Commission staff working document, Alert Mechanism Report 2024, SWD(2023) 902).

1. INTRODUCTION

This AMR initiates the thirteenth annual round of implementation of the Macroeconomic Imbalance Procedure (MIP). The procedure aims at detecting, preventing and correcting imbalances that 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 EU as a whole, and at eliciting appropriate policy responses. The implementation of the MIP is embedded in the European Semester of economic policy coordination to ensure consistency with the analyses and recommendations made under other economic surveillance tools (Articles 1 and 2 of Regulation (EU) No 1176/2011).

The AMR provides an overview of the economic developments that are taking place, and gives an overall assessment of the economic reading of the MIP scoreboard. It identifies Member States for which In-Depth Reviews (IDRs) should be undertaken to assess whether they are affected by imbalances in need of policy action (Article 5 of Regulation (EU) No 1176/2011). Taking into account discussions on the AMR within the Council and the Eurogroup, the Commission will then prepare IDRs for the Member States concerned. The IDRs will be published in early 2024 and will provide the basis for the Commission assessment of the existence and severity of macroeconomic imbalances, and for the identification of policy gaps. The AMR also includes an analysis of the euro area-wide implications of Member States' macroeconomic imbalances.

The AMR analysis is based on the economic reading of a scoreboard of selected indicators, which provides a filtering device for detecting first sight evidence of possible risks and vulnerabilities. Under Regulation (EU) No 1176/2011, the role of the Commission is to undertake an economic reading of the scoreboard values that enables a deeper understanding of the overall economic context and taking into account country-specific considerations°([5]). The AMR also builds on analytical tools and assessment frameworks, and additional published data, notably in-year data ([6]).

Building on the approach taken in recent years, the first screening for imbalances in the AMR is forward looking with a view of detecting risks of emerging imbalances early on. This could entail opening IDRs when adverse trends indicate high risks of a build-up of imbalances. To that end, this report uses forecasts, nowcasts and projections to better gauge the possible evolution of risks for macroeconomic stability. Values of scoreboard variables for 2023 and subsequent years have been estimated using Commission forecast data and nowcasts are based on in-year data ([7]). There is substantial uncertainty underlying those forecasts and it is necessary to bear this in mind in order to uphold the principles of transparency about analysis and data used, and prudence on the conclusions. The current approach to the AMR is consistent with the

([5]) On the rationale underlying the construction of the scoreboard and its reading see European Commission (2016), 'The Macroeconomic Imbalance Procedure. Rationale, Process, Application: A Compendium', European Economy, Institutional Paper 039, November 2016. The values of the scoreboard for 2022 are presented in Annex 2 below; see also Statistical Annex, Commission staff working document, Alert Mechanism Report 2024, SWD(2023) 902.

([6]) The cut-off date for the scoreboard data, i.e. the date on which data were extracted from the Eurostat database for the preparation of this report, was 31 October 2023. For any other data used, the cut-off date was also 31 October 2023.

([7]) For details, see Annex 2 of the Alert Mechanism Report 2023, COM(2022) 781 final.

Commission's proposal on the future of the surveillance of macroeconomic imbalances put forward in the context of the economic governance review ([8]). In particular, it aims at a stronger preventive role of the MIP in an environment characterised by new risks. The assessment of imbalances would be based more on the evolution of risks and policy action. The reformed MIP would focus on macroeconomic issues affecting Member States and at the same time, give more visibility to the EU and euro area dimensions of imbalances.

([8]) 'Communication on orientations for a reform of the EU economic governance framework', Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, COM(2022) 583 final.

2. MACROECONOMIC CONTEXT

This AMR is prepared against a backdrop of high but falling inflation and subdued economic momentum. In 2022, the year started with a solid expansion of activity that followed the recovery from the COVID-19 pandemic as supply bottlenecks vanished further and demand was expanding markedly amid still the post-pandemic reopening. That momentum was challenged by the energy price shock following Russia's invasion of Ukraine, which unleashed unprecedented inflation aggravating price pressures in a context of buoyant demand. The broad-based recession that had been widely expected over last autumn and winter did not materialise on account of diversification of energy sourcing and a marked reduction of energy consumption. Despite this overall resilience, the lagged effects of much higher energy prices and high inflation, reduced purchasing power, and marked monetary tightening, resulted in a noticeable slowdown throughout the year. Export performance weakened against a backdrop of subdued global trade, some lingering supply bottlenecks and rising energy costs, which weighed heavily on energy-intensive manufacturing sectors in European countries. Overall, the momentum softened over the course of the year and the EU economy has grown more modestly since late 2022, and a few countries have already recorded contractions in activity. In 2022 as a whole, real GDP growth reached 3.4% in both the EU and the euro area. Combined with high inflation, this has resulted in nominal GDP growth of 8.7% in the EU and of 8.2% in the euro area, with significant variations across countries, ranging from 5.5% in France to 20.7% in Bulgaria and 19.7% in Hungary (Graph 2.1).

Growth has been lacklustre in 2023 and the outlook is for a mild rebound in 2024, but possible headwinds remain as inflation continues to correct slowly and tighter monetary conditions may be felt with a lag. By early 2023, headline inflation had peaked in most EU economies and has since been coming down, sometimes markedly, as energy prices started to fall, but still remain clearly higher than before Russia's invasion of Ukraine. Core inflation, which started to rise with a lag, is now more persistent and is just marginally down from its peak ([9]). In the future, the fall in inflation, together with rising wages and a continued strong labour market, should help support purchasing power, leading to an expansion of consumption in the future. However, the effects of the cumulated monetary and financial tightening may have not yet fully filtered through and could have a lagged effect, dampening demand. Global trade is expected to pick up somewhat next year but to remain below long-term averages. In addition, export performance of EU countries may be further hampered by energy costs that increased by more than for other main competitors, and which may become permanently higher ([10]).

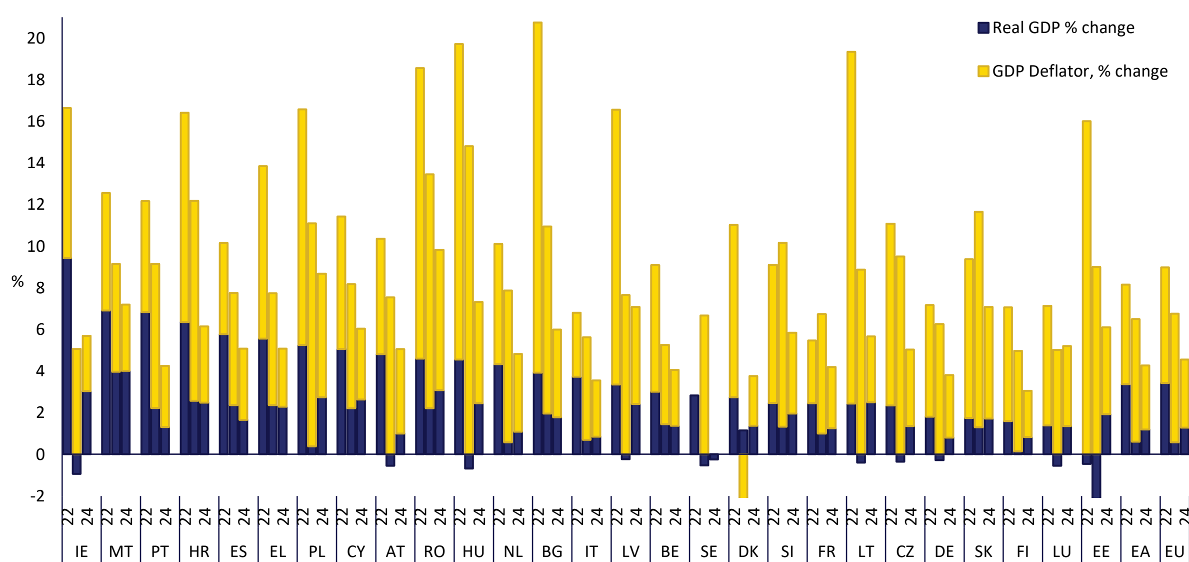
Uncertainty remains high, centred on the extent and speed of normalisation of inflation rates. The extent of pass-through of lower energy prices and of recent wage increases on core inflation are sources of uncertainty. The lagged impact of the historically unprecedented fast tightening of monetary and financial conditions, even if from very supportive levels, can be further impacted by prospective inflation developments and reactions to it. Uncertainty also remains high around the state of the global economy, and its implications for trade and external demand. According to the Commission autumn 2023 forecast, real GDP growth is expected at 0.6% in the EU

([9]) In this report, headline inflation refers to the 'All-items inflation' as provided by Eurostat; core inflation is defined as inflation excluding energy, food, alcohol and tobacco, as supplied by Eurostat too.

([10]) See also ECB, Economic Bulletin, Issue 03/2023, Box 3, 'The energy shock, price competitiveness and euro area export performance'.

and the euro area in 2023 and to advance by 1.3% in the EU and 1.2% in the euro area in 2024. In a few Member States, GDP is forecast to contract in real terms, even if only mildly, in 2023, while in 2024 almost all EU countries are expected to grow again. Price pressures are expected to abate gradually, but to remain significant for some time, resulting in nominal GDP growth of 6.6% and 4.4% in the EU in 2023 and 2024 respectively, with 6.5% and 4.3% in the euro area (Graph 2.1) ([11]).

Graph 2.1: **GDP growth in EU countries**



Countries are presented in decreasing order of real GDP % change in 2022.
Source: AMECO and Commission autumn 2023 forecast

The labour market has been strong with unemployment at record low levels. Employment has increased steadily and unemployment has reached historical lows in the course of 2023 (Graph 2.3 e). A range of indicators point to tight labour markets. This labour market resilience has occurred against a backdrop of increasing participation and higher employment rates, benefiting from long-term trends of rising labour market participation of women, older workers, EU mobile workers, and non-EU nationals ([12]). Moreover, the weakened economic momentum since late 2022 has not had a visible bearing on the labour market. Shortages of workers have been a lasting issue in a number of countries, often being already relevant before the outbreak of the pandemic crisis. There are risks that the labour market may weaken if the sluggish economic momentum lasts; job creation has already fallen in recent quarters even if remaining positive but continued labour market tightness and labour hoarding due to skills and labour shortages are expected to limit the labour market's response to the subdued economic momentum (Graph 2.3 e; Box 2.1). Productivity per worker has often been sluggish, amid increasing employment rates and a drop in the average number of hours worked per employee.

Nominal wages are now growing faster than inflation after lagging behind it in 2022. That is undoing some of the reduction in real incomes and underpinning consumption. In 2022, nominal wages grew strongly by historical standards, but still did not keep up with inflation across the EU and euro area, resulting in falling wages in real terms by -3.7%. In 2023, nominal wages have been accelerating as labour markets remain tight, which together with somewhat receding

([11]) European Commission, European Economic Forecast. Autumn 2023, Institutional Paper 258, November 2023. See also IMF (2023), World Economic Outlook, October 2023.

([12]) See Labour Market and Wage Developments Report in Europe, Annual Review 2023; ECB, Economic Bulletin, Issue 06/2023, Box 3, 'The euro area labour force: recent developments and drivers'.

inflation, is leading to real wage growth in several countries. That, together with rising headcount employment, has added resilience to household consumption and is expected to continue underpinning spending, while inflation recedes further. Nonetheless, cumulatively, households in many countries will still have experienced a reduction in real incomes over 2022 and 2023 and this may continue muting consumption in the near future.

While the peak in headline inflation seems to have passed, core inflation is displaying both persistence and continued divergence across countries. While headline inflation peaked in EU countries in late 2022 and early 2023, it remains well above central banks' targets. At the same time, inflation has broadened even if energy prices are now contributing to reducing inflation nearly everywhere; instead, inflation is now primarily driven by price increases in services and in non-energy industrial goods (Graph 2.3 a and b). Core inflation took longer to rise than headline inflation as the costs of higher energy fed into the prices of other goods and services only gradually. It has not been reducing to the same extent after reaching a peak in early 2023. Domestic inflationary pressures have increased, with unit labour costs and profit margins edging up markedly (Graph 2.3 c). Unit profits seem to have accounted for most of the inflation in many EU countries in 2022, which may have reflected the fact that firms adjusted their prices faster than wages on the impact of the cost shock and in a backdrop of strong demand (Graph 2.3 d) ([13]). In the future, some unwinding of the accumulated profits could allow firms to absorb higher costs rather than pass them onto prices, but the strength of demand and the pricing power of firms will be key determinants of the extent to which profits evolve. While further reductions in core inflation should be expected, as falling input prices feed through, core inflation may remain elevated due to persistent marked rises in labour costs. Unit labour costs have recently been clearly accounting for inflation, which is consistent with the more gradual reaction of wages described above (Graph 2.3 f). However, large cross-country differences have been recorded first in headline, and later, in core inflation. Those differentials have declined in recent months but remain clearly high. The cumulated effect of continued significant divergences in inflation can have serious implications for cost competitiveness (see Section 3.2).

Central banks have been tightening their stances and increasing their key interest rates from very low levels. Throughout the past year and a half, central banks, including the European Central Bank (ECB) and other EU central banks, have tightened their stances, mainly by a series of increases in their key interest rates from very low levels. In addition, euro area banks repaid maturing Targeted Longer-term Refinancing Operations III loans and the ECB stopped reinvesting the proceedings of securities maturing under its Asset Purchase Programme. The earlier stages of the tightening represented a monetary policy normalisation following the extraordinary support provided immediately after the breakout of the COVID-19 pandemic. It was followed by an historically very fast tightening of rates since mid 2022. Most EU central banks in non-euro area Member States, notably those with a floating exchange rate, have tightened their stance more markedly and earlier than the ECB, in response to much higher inflation rates domestically. At present, indications are that the tightening cycle may have largely ended, but some countries still remain marked by above the target inflation rates, which may mean that tight monetary and financial conditions may linger for long. At the same time, the interplay between the monetary stance and high inflation differentials remains a concern for the near future, as some economies experiencing below average inflation could see their credit and economic activity being asymmetrically affected by the sensibly higher real interest rates.

([13]) See also European Commission, SWD(2023) 903, Commission staff working document, 2024 Report on the euro area accompanying the Recommendation for a Council Recommendation on the economic policy of the euro area. See also ECB, Economic Bulletin, Issue 04/2023, Box 3, 'How have unit profits contributed to the recent strengthening of euro area domestic price pressures?'

Borrowing and lending dynamics have been clearly moderating. The higher monetary policy rates have quickly been passed on, resulting in higher interest rates charged to borrowers. That speed of transmission may have varied across countries reflecting also the structure of financing. In the euro area, credit standards have tightened substantially for households and non-financial corporations since early 2022 with higher risk perceptions owed to the economic outlook, lower risk tolerance, and higher cost of funds. In parallel, demand for loans has decreased strongly owing to lower investment needs, weaker housing markets, and lower consumer confidence. Surveys suggests that banks expect to tighten standards somewhat further and a further net decline in credit demand ([14]). As a result, lending dynamics have been moderating. Until early autumn 2023, yields increased visibly for euro area sovereigns. Yields and spreads have declined in most of the central and eastern European countries outside the euro area in the course of this year after more marked increases until late last year.

The EU banking sector is resilient amid sufficient capital buffers while profitability increased significantly in 2022, yet uncertainties continue to linger. Following an extended period of low interest rates and abundant liquidity, the ongoing tightening of financial conditions has significant implications for indebted households, non-financial corporations, and sovereigns, all of which can in turn have an effect on the financial system. The economic backdrop puts pressure on asset valuations, including real estate, which accounts for a significant share of bank lending and is widely used as collateral for loans. At present, investors are expecting a rapid decrease in inflation, which could contribute to easing financial conditions ([15]). Non-performing loans have been overall stable. The bankruptcies of some banks in the US and Switzerland in the first half of 2023 shook the global financial system. Although the markets have gradually calmed down, uncertainties about hidden vulnerabilities in the financial system persist. These vulnerabilities may be related to high leverage, mismatches between asset and liabilities, and increased interconnectedness between banks and non-banks ([16]).

Risks to the outlook are two-sided and affect imbalances. The new conflict in the Middle East, Russia's continued war against Ukraine and a generally changing geopolitical context, which may impinge on global trade and make external conditions difficult, are major factors of uncertainty. Inflation could surprise on both sides. It could turn out to be more persistent leading to tighter-for-longer financial conditions. Continued or further stress in global energy supply would drive energy prices higher, and marked wages and unit labour cost dynamics could lead to a renewed push on prices, particularly if profits are not adjusted to act as a buffer. Global supply chains are being re-shaped and that may lead to higher costs and compound price pressures. Conversely, inflation may recede faster than forecast, particularly if energy prices fall further and there is strong pass-through of those prices to other goods and services, and that would bode well for demand. Conversely, monetary and financial tightening may continue to have lagged effects, reducing demand and limiting current account deficits and external borrowing needs. Risks on the EU economy are closely related to the outlook for its key trade partners. The risks in China are on the downside, related to the downturn in the property sector and to high debt imbalances. Risks stemming from the US appear more balanced, as the disinflation process has progressed without a major dent in activity. Overall, global growth could also surprise on the downside, leading to a slower recovery in exports for EU countries, which may also be affected by global economic fragmentation and permanently higher energy prices. Global shifts, including technological ones and slow take up of them, can also harm growth prospects. Demographics and the green transition are other structural challenges that have to be dealt with. A surge in risk aversion in global

([14]) ECB, the euro area bank lending survey – up to the third quarter of 2023.

([15]) IMF (2023): World Economic Outlook Update: Near-term Resilience, Persistent Challenges, July 2023.

([16]) IMF (2023): Global Financial Stability Report: Safeguarding Financial Stability amid High Inflation and Geopolitical Risks, April 2023.

financial markets, possibly associated or triggered by some of the issues above, could add to volatility and test the financial systems.

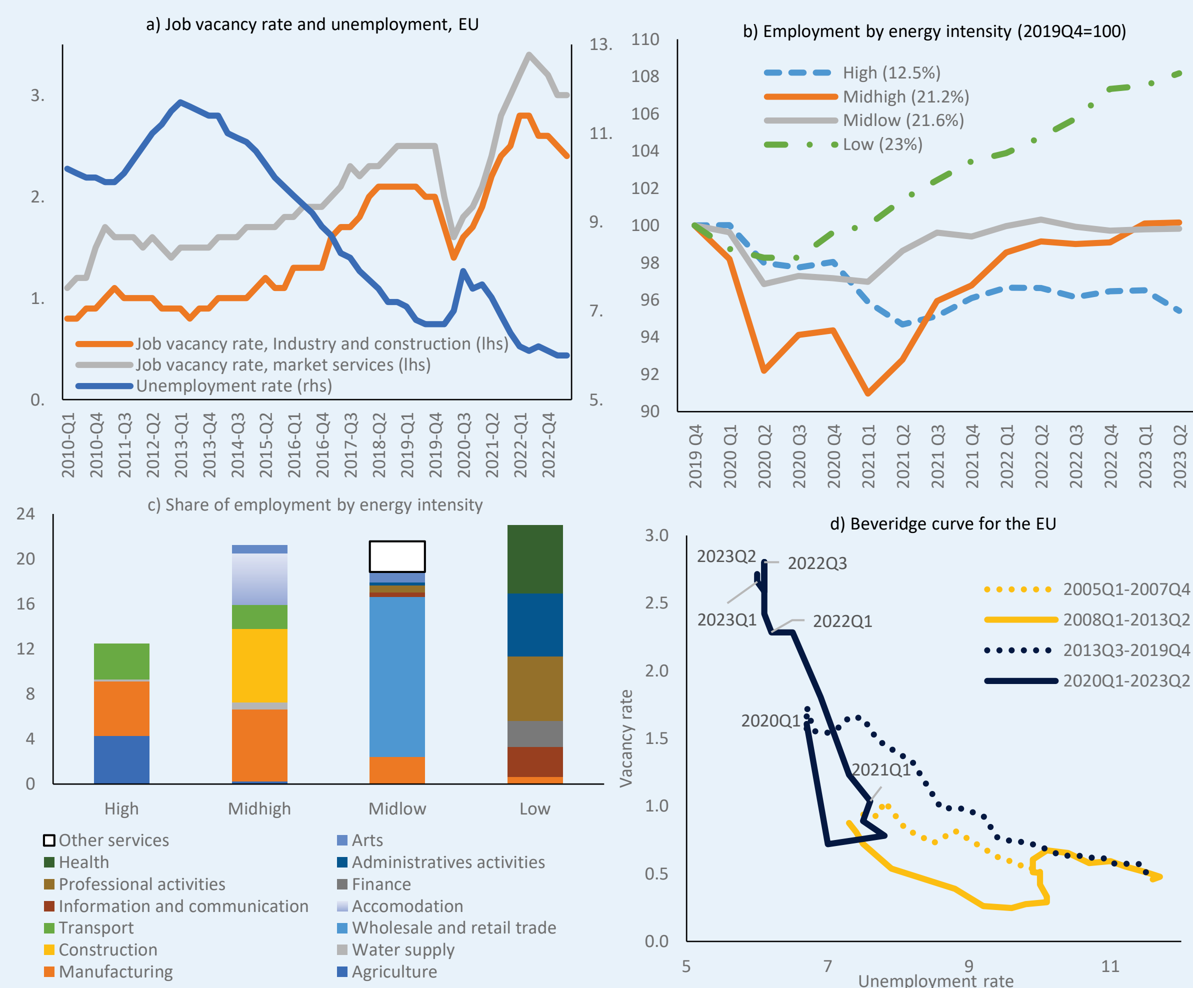
Box 2.1: Employment developments

In 2023, the EU labour market continued to perform strongly and is set to remain resilient despite the economic slowdown. Even though economic growth started to weaken in the course of 2022, the EU labour market proved to be particularly resilient. The unemployment rate edged further down to about 6%, and employment kept growing steadily (by 2% on an annual basis). In the first half of 2023, employment in the EU further rose by 1.3% on a yearly basis. This is higher than the 1% average increase experienced during the pre-pandemic period of economic expansion (2000-2019), despite much weaker economic growth. With the unemployment rate hovering at historical low in 2023, reaching 5.9% in May, and many firms reporting labour shortages, the EU labour market remains tight (Graph 2.2 a). The exceptional measures put in place to stabilise gas and electricity prices and reduce the EU's dependency on Russia have played an important role in avoiding a sizeable reduction in labour demand. Employment growth has also been supported by the increase in the participation rates.

The positive developments observed after the energy shock hide some differences in employment growth across sectors. Supply chain disruptions caused by the pandemic, Russia's war of aggression against Ukraine and the rise in the cost of energy have dampened employment growth in energy-intensive industries and transport. In the second quarter of 2023 employment in energy-intensive industries was about 4.5% lower than before the pandemic. By contrast, after a brief decline during the pandemic, employment in sectors with low energy intensity grew steadily (Graph 2.2 b and c). This difference across sectors also translated into different employment growth across Member States due to their specific industrial specialisation.

Looking forward, the labour market reaction to the subdued current and expected economic momentum is set to be mild. According to the Commission Autumn 2023 forecast, economic activity is expected to pick up only gradually. After the improvements registered until January 2023, employers' hiring intentions fell again in the subsequent 6 months. Nonetheless, continued labour market tightness and labour hoarding due to skills and labour shortages are expected to limit the labour market's response to the subdued economic momentum, as employers would first close unfilled vacancies before dismissing workers (Graph 2.2 d). Yet a prolonged period of low economic growth would most likely result in lower employment growth.

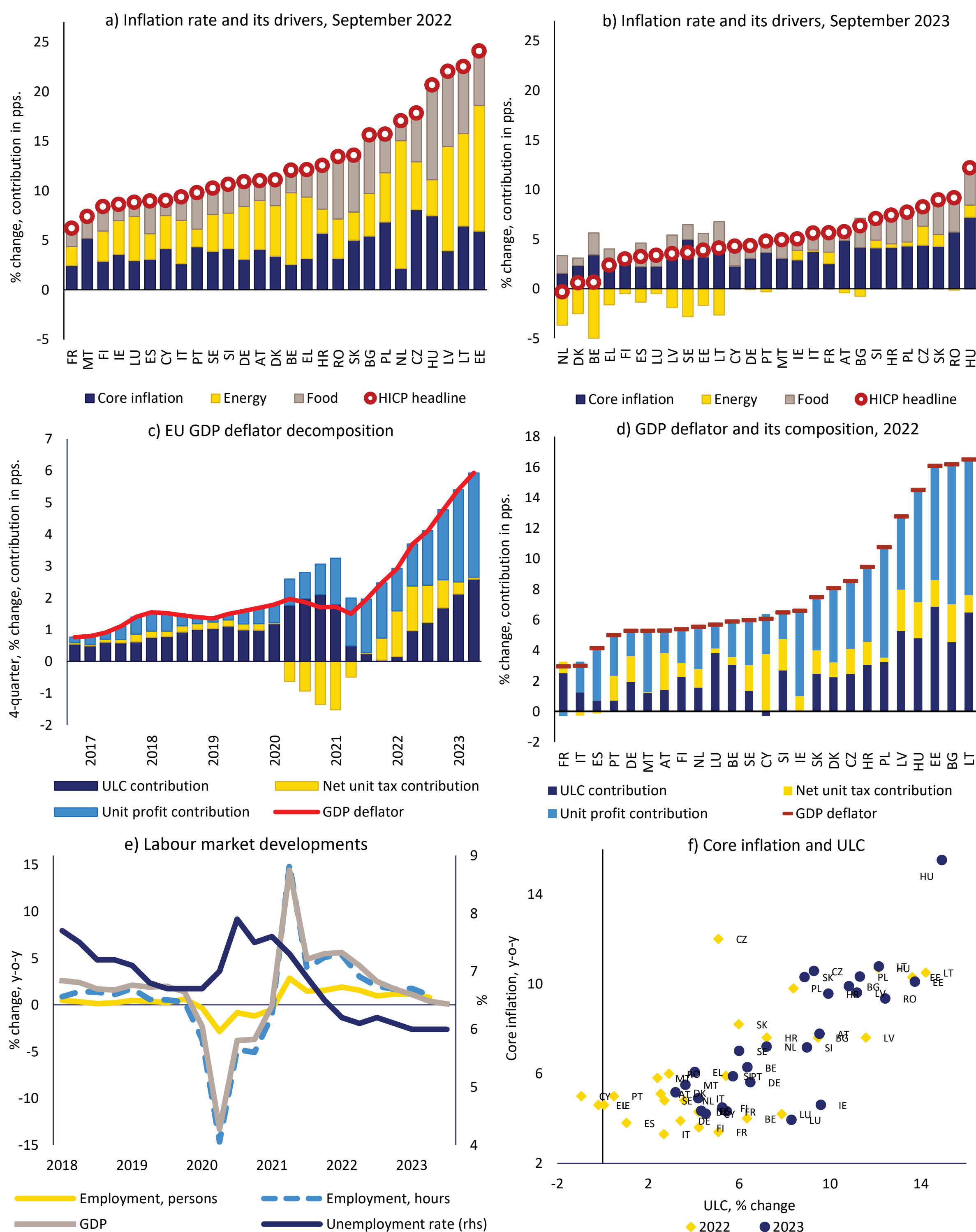
Graph 2.2: **Selected graphs on the labour market**



(1) In Panel b), the figures included after the series names refer to the respective share in total employment in 2020. In panels b) and c), the following sectors are excluded: mining and quarrying; manufacture of coke and refined petroleum products; electricity, gas, steam and air conditioning supply; public administration and defence; compulsory social security; education.

Source: Eurostat, Commissioncalculations.

Graph 2.3: **Selected graphs on the macroeconomic context**



Source: AMECO, Eurostat, Commission calculations. Panel d: data missing for Romania and Greece. Panel e: 2023 data for core inflation refers to the period January to September

3. IMBALANCES, RISKS AND ADJUSTMENT: MAIN DEVELOPMENTS

3.1. EXTERNAL SECTOR

Current account balances of almost all Member States declined significantly in 2022, primarily due to soaring energy prices. The current accounts of several net-debtor countries further plunged into deep negative territory, significantly below current account norms and below their pre-pandemic levels (Graph 3.1.1 a). Similarly, nearly all net-creditor countries experienced a decline in their current account balances, which nevertheless remained above levels suggested by the fundamentals of those economies ([17]). The surge in energy prices, which started in the second half of 2021 with rebounding economic activity and escalated strongly in 2022 amid Russia's aggression against Ukraine, greatly exacerbated energy goods deficits across most of the Member States (Graph 3.1.3 a) ([18]). Several Member States also witnessed notable deteriorations in their non-energy trade balances driven by resilient domestic demand sustained in part by gradually normalising savings rates ([19]). In addition, primary income balances declined in some EU countries, owing to lower investment income. The gradual recovery of international travel, particularly benefiting some net-debtor countries heavily reliant on the tourism sector, only slightly mitigated the negative effects in most cases.

Data for the first half of 2023 point to improving current accounts. This shift can be mainly attributed to an improvement in energy balances on account of a decline in energy prices, as well as the near-complete recovery of international tourism (Graph 3.1.3 b). Some countries heavily reliant on tourism have surpassed pre-pandemic travel balance levels, while others are steadily approaching them (Graph 3.1.3 e). Furthermore, for most countries, the balance of trade in goods excluding energy has also increased, driven mainly by volumes rather than price effects. In some Member States, a slowdown in domestic demand has played an important role. At the same time, the export performance has remained relatively robust in some countries, likely benefiting from the dissipation of supply bottlenecks.

Current account balances are projected to increase in nearly all Member States compared to 2022, but only a few countries will likely see their current account return to pre-pandemic levels. Improvements in trade balances are projected to drive current accounts in 2023 and 2024 (Graph 3.1.1 a). While these improvements are set to be driven mainly by price

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

([18]) Energy balance corresponds to balance of trade in energy goods, recorded under item 3 Mineral fuels, lubricants and related materials in the Standard International Trade Classification (SITC).

([19]) For some Member States, persistent supply chain disruptions, caused by the pandemic, may have contributed to declining trade balances, especially during the first half of 2022.

effects, volumes are expected to contribute in some Member States. The expected decline in domestic demand in 2023 will contribute to higher balances, particularly in countries with relatively resilient export sectors. Nevertheless, current account deficits are expected to remain sizeable in some cases despite the projected improvements. On the other hand, net-creditor countries are likely to see their current account balances increase again, remaining above the levels suggested by their economic fundamentals.

The reversal in current account developments is underway as major shocks of the past 3 years seem to be dissipating. Energy prices have fallen substantially from their 2022 highs but are expected to remain above the levels seen before the pandemic ([20]). As a result, energy balances will keep current account balances lower, especially in countries heavily reliant on energy imports. In addition, the pandemic had a lasting impact on tourism sectors, but the 2023 summer season hints at a full recovery of the sector ([21]). In addition, supply chain disruptions continue to mend, supporting trade, but the net effect on trade balances is unclear ([22]). High inflation and tightening financing conditions have decelerated real domestic demand with a mild contraction seen in nearly half of Member States further supporting the pick-up in trade balances.

In 2022, the net international investment positions (NIIP) continued to narrow in nearly all EU countries. The narrowing can be attributed to robust nominal GDP growth in most countries and, to a lesser extent, valuation effects, which dwarfed the impact of the increased current account deficits (Graph 3.1.3 f). Net-debtor countries seem to have reduced their NIIPs slightly more than net-creditor countries reduced theirs also thanks to their lower reliance on energy and a rebound in the services sector. The gap between the aggregate net positions of net-creditors and net debtors returned to close to its 2019 level. For most of the large net-debtor countries, the recent current account outcomes remained below the levels necessary for the correction of their negative stocks, as estimated by prudential or fundamental benchmarks ([23]) (Graph 3.1.1 b). On the other hand, the NIIPs of several net-creditor countries have remained considerably higher than what can be explained by economic fundamentals. NIIP-to-GDP ratios are projected to increase in nearly all Member States for 2023 and 2024 while remaining below prudential levels in many large net-debtor countries.

From a sectoral perspective, the net external lending/borrowing position experienced a decline across nearly all countries in 2022 mainly due to a decreasing net position of the private sector. The worsening in net positions of households and corporations largely outweighed the improvements in government sectors. Increased household spending, also fuelled by rising living costs, accelerated the continued correction of elevated savings. Despite increasing unit profits, corporations further contributed to the decline in the private sector's net position, owing to an increase in investment and a pronounced fall in property income. On the other hand, governments clearly reduced their negative net positions, as the cost of energy support measures was lower compared to those related to the COVID-19 pandemic (Graph 3.1.3 d). In 2023, nearly all

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([20]) The price of natural gas and electricity is expected to remain over 270% above the average 2019 levels, while the price of oil is expected to be about a third above its 2019 average price in 2024.

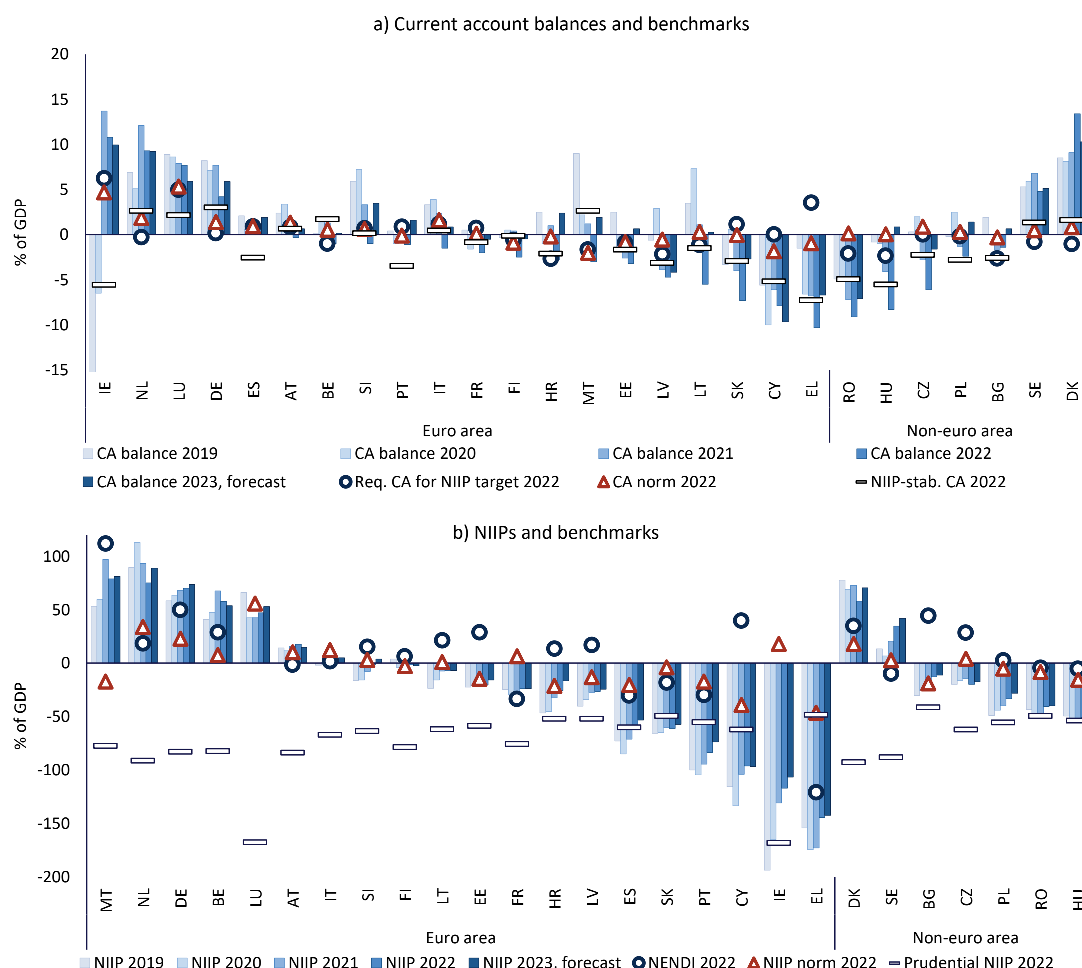
([21]) The performance of tourism sectors can be gauged by the number of nights spent by foreign tourists.

([22]) See EC (2023), External Sustainability Analysis: Thematic Note to Support In-Depth Reviews, European Commission, Institutional Paper No. 196 and references therein.

([23]) The current account required to reach a specific NIIP target is the current account required to reach the prudential threshold over the next 10 years, or to halve the gap to the NIIP in line with fundamentals, whichever is higher. NIIP prudential thresholds are determined from the maximisation of the signal power in predicting a balance of payment crisis, taking into account country-specific information summarised by per-capita income. The NIIP in line with fundamentals (NIIP norms) are obtained as the cumulation over time of the values of the current account norms. For the methodology for the computation of NIIP prudential and fundamental benchmarks, see A. Turrini and S. Zeugner (2019), Benchmarks for Net International Investment Positions, European Economy, Discussion Paper 097/2019.

Member States are forecast to witness an increase in the net positions primarily driven by the private sector. In some cases, the government is expected to increase its net borrowing, which will worsen the total net borrowing/lending positions of those economies.

Graph 3.1.1: **Current account and net international investment position over time**



Countries are ranked in increasing order of current account balances in 2022, and in decreasing order of the NIIP-to-GDP ratios in 2021. CA stands for current account. NENDI is the NIIP excluding non-defaultable instruments. Current account norms: see footnote 17. For the concepts of NIIP norm, NIIP prudential threshold, and NIIP-stabilising current account benchmark and required CA for reaching specific NIIP target: see footnote 23.
Source: Eurostat and European Commission calculations

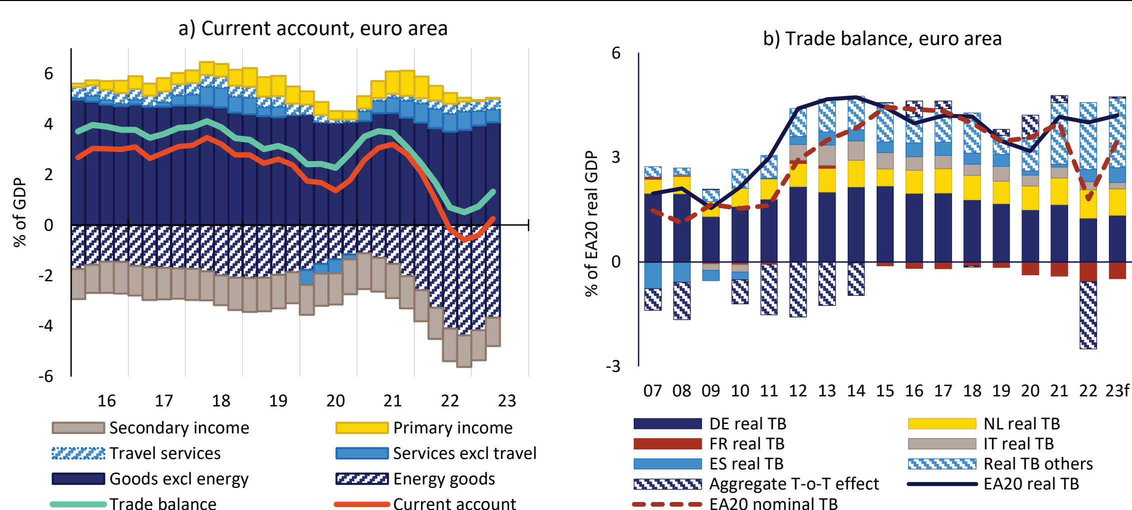
Persistent economic and geopolitical uncertainties, along with global monetary tightening, may lead to tighter external borrowing constraints in case of increased risk aversion. Countries with substantial current account deficits and significant negative NIIPs, particularly outside the euro area, may experience tighter external borrowing constraints if there is heightened risk aversion in global financial markets. Even though recent currency developments have shown appreciating trends for most of non-euro area Member States, financial market stress could lead to capital outflows and currency depreciations, exacerbating pre-existing economic vulnerabilities. Increasing geopolitical tensions risk economic fragmentation impacting trade and capital flows.

The euro area's current account underwent a significant decline in 2022, falling from a surplus of 2.8% of GDP in 2021 to a deficit of 0.6%. The key driver was the fall in the trade balance resulting from unfavourable price developments, as the trade balance in real terms remained broadly stable from 2021 (Graph 3.1.2. b). Specifically, the energy balance plummeted

from -2.0% in 2021 to -4.4% of GDP in 2022. The worsening extended beyond energy goods, with the balances of trade in non-energy goods falling to 3.8% of GDP in 2022 from 4.3% of GDP in 2021, amid relatively strong domestic demand (Graph 3.1.2 a). The balance of primary income fell by 0.8 percentage points (pps), owing to lower investment income. While most euro area countries experienced declines in their current account balances, the reduction of the euro area surplus was primarily driven by Germany, whose contribution to the euro area current account balance nearly halved compared to 2021. France and Italy made substantial negative contributions while the positive contributions of the Netherlands and Ireland decreased slightly.

In 2023, the euro area current account has returned to a small surplus, as the negative shocks abate. The euro area has seen an increase in its trade balance driven by both energy and non-energy goods (Graph 3.1.2 a). On a four-quarter-moving-sum basis, the energy balance increased by 0.7 pp in the first half of 2023 compared to 2022, and the non-energy goods balance increased by 0.3 pps., owing to both nominal and real effects. Terms of trade have improved slightly while domestic demand seems to have eased somewhat faster than global demand in real terms. Primary and secondary income balances have not changed materially in the same period. As a result, the current account returned to surplus, posting 0.2% of GDP in the second quarter of 2023. In the future, the euro area trade and current account balances are forecast to increase further in the rest of 2023 and 2024 but are set to remain well below their pre-pandemic levels ([24]). Both energy and non-energy goods balances are expected to remain lower while services balances are projected to exceed their pre-pandemic levels.

Graph 3.1.2: **Current account and trade balance of the euro area**



'Physical goods' is the balance of trade of SITC total; 'Energy goods' corresponds to balance of trade for the SITC3 category, while 'Non-energy goods' is the difference between the two.
Source: Eurostat and European Commission calculation

([24]) Note that due to an exceptionally low current account balance in Ireland in 2019, the euro area current account is forecast to increase above its 2019 level. However, it is forecast to remain below the levels posted in 2017 and 2018.

Countries with current account balance (3 year average) in % of GDP above 6% or below -4% in 2022 in blue																										
BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE

Countries with NIIP (% of GDP) below -35% in 2022 in blue																										
BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE

At country level, the following developments are worth highlighting:

- In 2022, the current account balances, based on 3-year averages, of four Member States were below the lower scoreboard threshold of -4% of GDP: **Cyprus, Greece, Hungary** and **Romania**. At the same time, five Member States had averages above the upper threshold of 6% of GDP: **Denmark**, **Germany**, **Ireland**, **Luxembourg** and **the Netherlands**. The surplus, based on 3-year averages, in Germany is however projected to fall below the threshold in 2023 and 2024. As for the NIIP readings, they were below the scoreboard threshold of -35% of GDP for eight Member States: **Cyprus, Greece, Hungary, Ireland, Portugal, Romania, Slovakia** and **Spain.**

- The current accounts of **Cyprus** and **Greece** further deepened their already significant deficits in 2022. **Spain** saw a slight reduction in its surplus, while **Portugal** slightly increased its current account deficit. The current accounts of Greece, Cyprus and Portugal remained below the levels suggested by economic fundamentals, albeit to varying degrees. In the future, current accounts surpluses are forecast for Spain and Portugal. The current account deficits are expected to reduce but to remain sizeable in Greece and in Cyprus by 2024. NIIPs for all these countries have been improving primarily due to strong nominal economic growth and valuation effects. Further improvements are expected for all these countries except Cyprus in the future, albeit at a slower pace.

- The current accounts of **Hungary** and **Romania** have been on a multiannual declining trend. In 2022, Hungary's current account deficit sharply worsened due to a decline in the energy balance, while Romania's deficit was affected by both non-energy and energy goods. In both cases, governments contribute substantially to the economies' external borrowing needs. Despite some improvement, the current account deficit in Romania is forecast to remain sizeable and significantly below both pre-pandemic levels and fundamentals. In Hungary, the current account deficit is forecast to close in 2023. Foreign reserves, having fallen below three months' worth of imports, and the volatility of the forint, contribute to concerns about external sustainability in Hungary. Both Hungary and Romania hold negative NIIPs, of which foreign direct investments represent a large share, making their NIIPs excluding non-defaultable instruments more favourable.

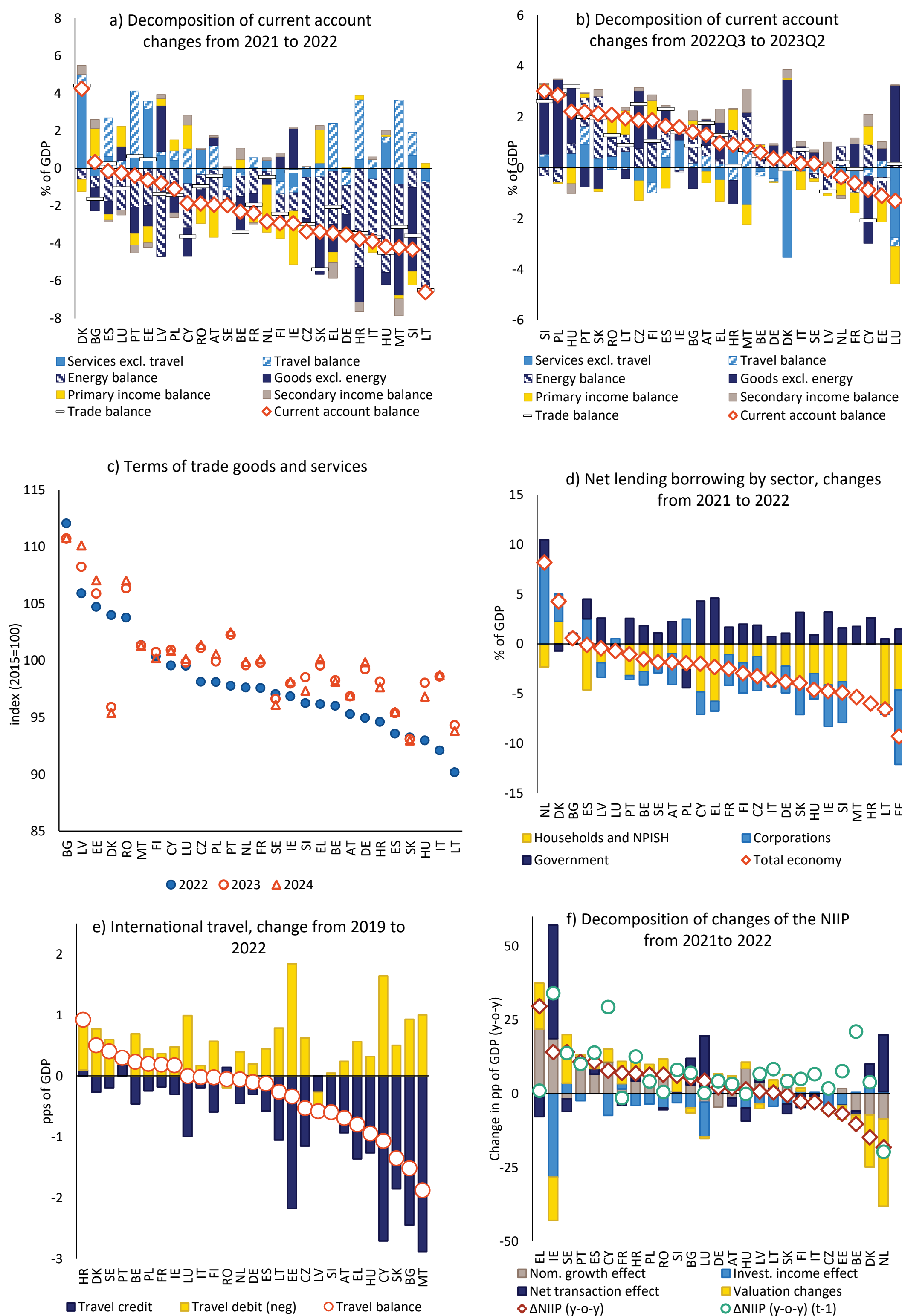
- Current accounts in **Czechia, Latvia, Lithuania** and **Slovakia** fell into large deficits in 2022, primarily due to a deterioration of their energy balances. **Estonia** and **Poland** also saw their current account deficits widening. Current accounts are expected to improve in all these countries, though to a varying degree, with Estonia, Lithuania and Poland likely to record small surpluses in 2023 and beyond. Czechia's current account is forecast to remain in a small deficit while the deficits in Latvia and Slovakia are projected to remain sizeable. The negative NIIP for Slovakia is thus set to remain sizeable.

- The current account surpluses of **Denmark, Germany, Ireland, the Netherlands** and **Sweden** exceed their norms. In 2022, Denmark experienced a notable increase in its surplus, with the exceptional revenues of logistics companies boosting the balances. The Netherlands, Germany, Ireland and Sweden recorded a decline in their surpluses. **Germany's** decline was

predominantly driven by a worsening in the terms of trade, as well as resilient domestic demand. The current accounts in the Netherlands and Ireland, were mainly affected by changes in the primary income balances while goods and service balances worsened the current account in Sweden. Current account balances are expected to remain high, above fundamentals, in all these countries although the current account of Germany is forecast to remain below 6% in 2023, before increasing again in 2024. The NIIPs of all these countries, except of Ireland greatly exceed the levels suggested by economic fundamentals. The NIIP of Ireland remains deep in negative territory.

- **Belgium**'s current account declined strongly throughout 2022 and is projected to remain below its pre-pandemic levels. Nevertheless, the country's NIIP remains firmly in positive territory. While **France** recorded a deficit in 2022, it is forecast to remain only slightly negative over the forecast period.

Graph 3.1.3: **Selected graphs on the external sector**



Source: Eurostat and European Commission

3.2. COMPETITIVENESS

The EU has been marked by significant cost and price pressures over the past two years, with strong and divergent dynamics. Inflationary pressures, which started to pick up in late 2021, became widespread but also divergent. In an initial phase, until mid-2022, inflation divergences were principally driven by the differentiated impact of the higher energy prices. This reflected differences in energy sourcing and in energy market structures across countries, and in policy responses. The fact that the weights of energy and food vary widely across the EU, and is very high in some countries, has also contributed to different dynamics in costs and prices following the increases of the prices of energy and food in international markets ([25]). Inflationary pressures subsequently widened to other goods and services, resulting in rising and diverging core inflation across the EU in 2022 and 2023. With the fall in energy prices, in particular natural gas, since late summer 2022, and the more recent and smaller reduction in food inflation, headline inflation has fallen since the turn of the year, but not in a uniform way across the EU. While also falling, core inflation is just marginally off its peak in recent decades. Divergences across countries continue being significant, including at the level of core inflation, even if reducing somewhat over the course of 2023. These issues compound the challenges of a more structural nature, including those related to the transition away from fuel fossil energy and minding the EU's high energy imports dependency, and risks of global trade fragmentation ([26]).

Unit labour costs have been rising markedly across the EU amid high inflation and tight labour markets. Unit labour costs (ULC) rose strongly in 2022 in several EU countries. Many of those countries had displayed significant ULC growth already in earlier years, including before the pandemic, but recent readings are often the highest over recent decades. The marked ULC increases in 2022 were driven by strong wage rises resulting from tight labour markets and high inflation, while wages and ULCs declined in real terms. Labour productivity grew in most countries amid marked expansions of output, but in some – especially in the euro area – countries, output per worker stagnated or even declined. This added further pressure to ULC (Graph 3.2.1 a and b). Outside the euro area, countries with very high ULC growth displayed productivity growth that mitigated some of the very high increases in compensation but clearly were not enough to prevent that marked growth in ULC. At the same time, unit profits increased in most EU countries too and accompanied the increase in inflation in various cases (see Section 2 and Section 3.3) ([27]).

In 2023, unit labour costs are accelerating in most countries driven by high wage growth with some moderation expected only next year. In almost all EU countries, ULC are expected to have grown faster this year than last year (Graph 3.2.1. b). In 2023, the marked increases in ULC

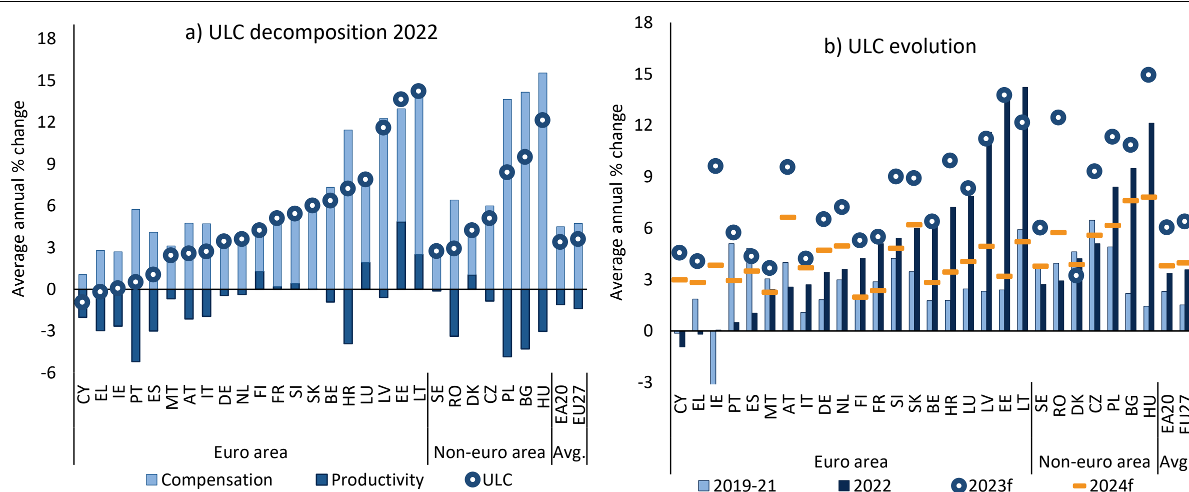
([25]) The same increase in the price of energy and other commodities will generate a larger change in the inflation rate the lower the price level of other goods and services; i.e. economies with overall low price levels will see their inflation rise more as a consequence of the same shock, e.g. coming from international markets. Thus, countries with lower price levels are likely to have been more affected by the absolute increase in the prices of energy and other commodities in global markets, as those goods weigh more on costs, mirroring the fact that labour costs tend to have a lower weight in total costs. See also European Commission (2023), 'Inflation Differentials in Europe and Implications for Competitiveness: Thematic Note to Support In-Depth Reviews' (europa.eu), Institutional paper No. 198, April 2023.

([26]) See also European Commission, SWD(2023) 903, Commission staff working document, 2024 Report on the euro area accompanying the Recommendation for a Council Recommendation on the economic policy of the euro area.

([27]) Hansen, Niels-Jakob, Frederik Toscani, Jing Zhou. 2023. "The Role of Import Prices, Profits and Wages in the Current Inflation Episode in the Euro Area" IMF Working Paper 23/131, International Monetary Fund, Washington, DC.

have been primarily driven by stronger pay rises, as employees require higher salaries to make up for the recent, and sudden, losses in purchasing power, against a backdrop of tight labour markets and skill shortages (Graph 3.2.4 a). In addition, productivity per worker is stagnating in most countries and even receding in some cases in a context of the weak economic momentum. In 2024, prospects are for ULC growth to generally decelerate, sometimes quite markedly, but to still remain positive in all EU countries and high in some, as wages are expected to grow at a more moderate pace, but the uncertainty remains high as wages are dependent on negotiations that have not yet taken place in many countries, while productivity should edge up. Continuously strong ULC increases could, in turn, drive second-round effects and risks of further price hikes, resulting in the persistence of high inflation.

Graph 3.2.1: **Unit labour costs decomposition and evolution**



Source: AMECO; European Commission autumn 2023 economic forecast

In 2022, export market shares were dampened by price effects, and global trade patterns had a negative impact on manufacturing and a positive one on tourism, and those patterns have extended into 2023. The particularly high energy cost increase in Europe and higher prices of other commodities had the effect of increasing the value of total global trade due to price effects in 2022. As EU countries are net energy importers, their export market shares automatically shrunk due to this denominator effect, while the opposite occurs with falling energy prices. At the same time, sluggish world trade, in particular in goods, in the second half of the year and into 2023, had a negative impact on countries with sizeable manufacturing sectors ([28]). Conversely, service exports, in particular tourism, expanded partly due to a still post-pandemic normalisation, increasing the export market shares of economies with important international tourism sectors. In the future, trade in goods may be subdued for some more time, while the tourism normalisation seems to have run its course; as a result, external demand could limit scope for export-led expansions.

Nominal effective exchange rates depreciated for most of the EU countries in 2022, in line with the euro itself, but have appreciated for most of the current year. The euro depreciated over most of 2022, but outside the euro area the picture is more mixed. Despite appreciations that started in the final quarter of 2022, the overall effect was for a depreciation of the nominal effective exchange rates for 2022 as a whole for nearly all EU countries (Graph 3.2.4 d). The nominal appreciation of the euro continued until early summer 2023, with a reversal

([28]) See, for instance, ECB, Economic Bulletin, Issue 04/2023, Box 3, 'The energy shock, price competitiveness and euro area export performance'.

thereafter. Outside the euro area, only the Swedish krona has recorded a continued depreciation in 2023, while the rest of the currencies of non-euro area Member States appreciated or broadly stabilised against the euro until summer. Consequently, prospects are that nominal effective exchange rates appreciate in all EU countries bar Sweden, including in the euro area ones, for 2023 as a whole.

Some countries have been experiencing strong real appreciations, driven by higher inflation than in trading partners. Throughout 2022, real effective exchange rates diverged strongly, and despite the nominal depreciations, in some cases, both inside and outside the euro area, real effective exchange rates appreciated, sometimes significantly so (Graph 3.2.4 d). Since the beginning of the recent inflationary period in late summer 2021, a number of countries, both inside and outside the euro area recorded marked appreciations, particularly in those with high inflation rates (Graph 3.2.4. e). Outside the euro area, in 2022, the strong depreciations of the Hungarian forint, Polish zloty and Swedish krona, counteracted the impact of high inflation on the real effective exchange rates, but already over most of 2023, Hungary and Poland have experienced nominal and real appreciations. Overall, as EU countries mostly trade among themselves, the impact of variations in nominal exchange rate tend to be limited, especially of course for the euro area members, which adds to the relevance of inflation differentials.

Current challenges for competitiveness are chiefly related to the evolution of inflation differentials within the euro area and the EU. In 2023 to date, changes in the HICP-based REER have pointed to appreciation nearly everywhere driven by nominal appreciations of almost all EU currencies. Within the euro area, continued divergence in inflation rates, which is also evident in core inflation, raises the prospects of worsening competitiveness becoming entrenched in some cases (see Graph 3.2.4 e). In addition, the euro area countries that had recorded the largest real appreciations in 2022 have kept recording significant real appreciation in 2023, and that was also the case for some Member States outside the euro area. More heterogeneity is expected across non-euro area countries, partly reflecting different nominal exchange rate policies but which are in some cases compounded by very high inflation rates, including core inflation.

Significant divergence in price and cost dynamics risk becoming entrenched and some challenges related to higher energy prices may remain. Cross-country differences in core inflation, especially if lasting, raise the prospect of impaired competitiveness within a currency area. In some countries with high inflation in 2022, the reduction in inflation rates slowed down in the course of 2023 and in all cases the differentials vis-à-vis the euro area and the rest of EU are still higher than before the beginning of this period of higher inflation (see Box 3.2.1 for details). In many cases, inflation in 2022 was accompanied by a sizeable increase in unit profits along with strong ULC growth (see also Section 2), with price and labour cost dynamics reinforcing each other. Wage dynamics are particularly relevant for services inflation, which has recently been slightly higher than core inflation. In parallel, as energy prices are still higher than before Russia's invasion of Ukraine, the production and competitiveness potential of the most affected economies remains under pressure, which may linger as a concern if those prices remain permanently higher. That highlights the importance of accelerating structural changes that may entail important adjustment costs and new policy needs.

Strong and divergent price and wage dynamics may reinforce each other and harm competitiveness and external balances, and impact the transmission of the monetary stance, which is a particular concern for euro area members. The risks of price-wage spirals do not appear to be strong, and the increase in unit profits that has occurred may offer a buffer for firms to absorb higher wages, without passing them onto prices ([29]). However, should the

([29]) See, for instance, Box 1 in European Commission, SWD(2023) 903, Commission staff working document, 2024 Report on the euro area accompanying the Recommendation for a Council Recommendation on the economic policy of the euro area.

divergence across countries in price and wage dynamics persist, and not be matched by productivity gains, there may be lasting competitiveness pressures. Higher inflation may increase expectations about future inflation and lift wage demands, which in turn could prevent lower inflation. Those concerns are heightened in the case of euro area countries as the re-alignment of domestic costs and prices via changes in the nominal exchange rate is not an option. At the same time, divergent inflation across the euro area makes the task of the monetary authority particularly difficult, as the uniform transmission of changes in monetary stance to all parts of the monetary union may be impaired with real interest rates differing across the euro area.

Large net external debtor countries in the euro area have been less affected by competitiveness losses, which has contributed to more symmetric rebalancing of the large external stock positions within the monetary union. Since late 2021, unit labour costs have grown less in large net-debtor euro area countries than in large net-creditor ones and than in the rest of the euro area (Graph 3.2.4 f), thereby supporting external rebalancing within the area. However, developments in inflation, and in particular in core inflation, are a reason for caution: they have not differed much between some of the large net-creditor countries and some of the net debtors. This might dampen the rebalancing effect in the future. In parallel, in 2022, the large net-creditor countries may have gained more from a depreciation of the euro given their higher share of extra-euro area trade, although net-debtor countries have, overall, continued to benefit from expanding tourism exports.

For non-euro area countries, nominal exchange rate depreciation may mitigate part of the cost competitiveness pressures, but brings in other challenges. While non euro area countries have more flexibility when it comes to external adjustments given their sovereign monetary and exchange rate policies, there are limits to this. Nominal depreciations could result in further increases in domestic inflation (in a period in which inflation rates are high already and sticky) as imported goods and services become more expensive, feeding second-round effects. They could also hamper the repayment of foreign denominated debt, with countries with large liabilities in foreign currencies facing particular constraints in terms of the impact of nominal depreciations on their financing costs. In addition, volatile exchange rates can negatively affect investment flows, while repeated or expected depreciations can affect external borrowing on account of higher risk premia.

Countries with nominal unit labour cost growth (3 year % change) above 9% (EA) or 12% (non-EA) in 2022 in blue																										
BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE

Countries with export market share, % of world exports (5 year % change) below -6% in 2022 in blue																										
BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE

Countries with REER, HICP deflator (3 year % change) above +/- 5% (EA) and +/- 11 (non-EA) in 2022 in blue																										
BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE

At country level, the following developments are worth highlighting:

- Unit labour cost growth, cumulated over the three years to 2022, was above the scoreboard threshold in 16 Member States: **Austria, Belgium, Bulgaria, Czechia, France, Estonia, Hungary, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, Slovenia, Slovakia**, and **Spain.** For the HICP-based REER, the three-year changes were beyond the scoreboard thresholds in four Member States: **Czechia, Estonia, Latvia**, and **Lithuania**. Six Member States exceeded the scoreboard threshold for the changes in export market shares in the five years up to 2022: **Czechia, France, Germany, Italy, Slovakia**, and **Spain**.

- Concerns about cost pressures have been significant and are persisting in **Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania**, and **Slovakia.** In these countries both headline and core inflation have been well above euro area and EU averages. Hungary and Romania stand out on account of their recent high core inflation; core inflation differentials vis-à-vis the euro area are notable for Lithuania and Slovakia. Bulgaria, Czechia, Estonia, Latvia, Lithuania, Romania, and Slovakia have recorded real appreciations, which have continued in 2023, adding to competitiveness concerns. In Hungary, marked nominal depreciations offset the impact of sharp price rises in 2022 and led to real depreciation. In all these cases, ULCs have been growing much faster than in the euro area or the rest of the EU, and prospects are for ULC growing even faster in most of these cases in 2023 than in 2022. Taking 2022 and 2023 together, ULC growth is estimated to have been particularly high in Estonia, Hungary, and Lithuania, and also notable in Latvia, Bulgaria and Poland. Czechia and Slovakia have recorded considerable export market share losses in the last few years. Recently, substantial falls in inflation have been noted in Estonia, Latvia, and Lithuania, but core inflation differentials vis-à-vis the euro area are still visible. See Box 3.2.1 for additional information on inflation developments in these countries.

- **Austria, Belgium, Luxembourg**, and **Slovenia** have recently displayed some risks of cost competitiveness losses. All of them have shown strong ULC dynamics in recent years. Those ULC increases are expected to continue and to accelerate further this year, in particular in Austria. Core inflation in all these countries except Luxembourg has exceeded that in the euro area by visible margins, more significantly in Austria and Slovenia.

- Cost competitiveness has overall improved in large net-debtor euro area countries. In particular, ULCs have been growing less than in trading partners and the rest of the euro area, growing only moderately in **Portugal** and **Spain** and even falling somewhat in **Cyprus** and **Greece** in 2022; despite some accelerations in 2023, they are expected to remain below the euro area average. Headline inflation has typically been below or even well below the euro area average; in the case of Cyprus and Spain this is also the case for core inflation. Apart from Cyprus, export market shares have edged up markedly on account of clear recoveries from the sharp losses recorded in the sizeable tourism sectors with the worst of the COVID-19 crisis in 2020. In the cases of Spain, and to some extent Portugal, that has not yet been enough to offset earlier losses in export market shares.

- Developments in large net-creditor countries may marginally contribute to facilitate a more symmetric adjustment of external positions within the euro area. In particular, ULC are growing somewhat faster than in the rest of the euro area, especially in 2023. In **Germany**, headline and core inflation have been above but very close to the euro area average. However, real depreciation was relevant in 2022 on account of the nominal depreciation of the euro, which was particularly impacting given its large weight of extra-euro area trade. In **the Netherlands**, core inflation has been above the euro area. Against the backdrop of those cost competitiveness developments, weaknesses in manufacturing and in global goods trade since

mid-last year seem to have hurt export market shares of these Member States, especially Germany, which recorded visible losses in 2022.

Box 3.2.1: Zooming in on inflation developments in selected Member States

This box looks at inflation developments in more detail for selected Member States. These include the Member States for which an In-Depth Review was prepared in 2023, with a specific emphasis on competitiveness and which were covered in the thematic note on inflation differentials published in April 2023 ([30]). Bulgaria, Poland, and Croatia are also considered in light of the recent developments. This box aims at taking stock of more recent data, and, for the countries where the IDR concluded that imbalances were not present, to act as a follow-up to that assessment.

Inflation has been, and often remains, well above euro area and EU averages in these countries (Graph 3.2.2. a and b). Most of them were particularly impacted by the higher energy prices in 2022 on account of their sourcing of energy, higher weights of energy on output and on consumption baskets, and lower overall price levels, which makes them more sensitive to increases in energy and commodities prices in world markets. Food inflation too has been clearly higher than in the euro area and the EU and weighs more in the consumption baskets in these countries than in higher income ones, and has been adding to headline inflation (see Table 3.2.1).

All those dynamics have clearly spilled into other goods and services, leading to high core inflation, which has been and remains well above the euro area in all these cases. Core inflation and the differentials vis-à-vis the euro area are visibly higher than in late summer 2021 when inflationary pressures became more noticeable (Graph 3.2.2. b and d).

In recent months, both headline and core inflation are falling in these countries, with the exception of Romania. In Romania, core inflation continues to increase, reaching a record high in September 2023, while the differential with respect to the euro area remains on the rise recently even though it had been somewhat more limited than in the other countries reviewed here (see Table 3.2.1 and Graph 3.2.2 d). The reductions in headline inflation have been more visible reflecting also the fact that energy prices had typically increased more than elsewhere and are now falling in most countries (Graph 3.2.2 c). Despite recent reductions, strong inflationary pressures clearly linger and at the level of core inflation too, with differentials vis-à-vis the euro area and the rest of EU being higher than before the beginning of this period of higher inflation (Graph 3.2.2 d). Hungary and Romania display double-digit core inflation rates, while the others recorded just-below double-digit core inflation readings in recent months. In addition, in September, energy inflation was still positive in Czechia, Hungary, and Slovakia, and to a lesser extent in Croatia and Poland, often reflecting the phasing out of price caps on some energy goods. At the same time, Hungary, Poland, Romania and Slovakia stand out for their clearly high food inflation in 2023, which has just fallen in recent months but is still above the headline inflation rates (Table 3.2.1).

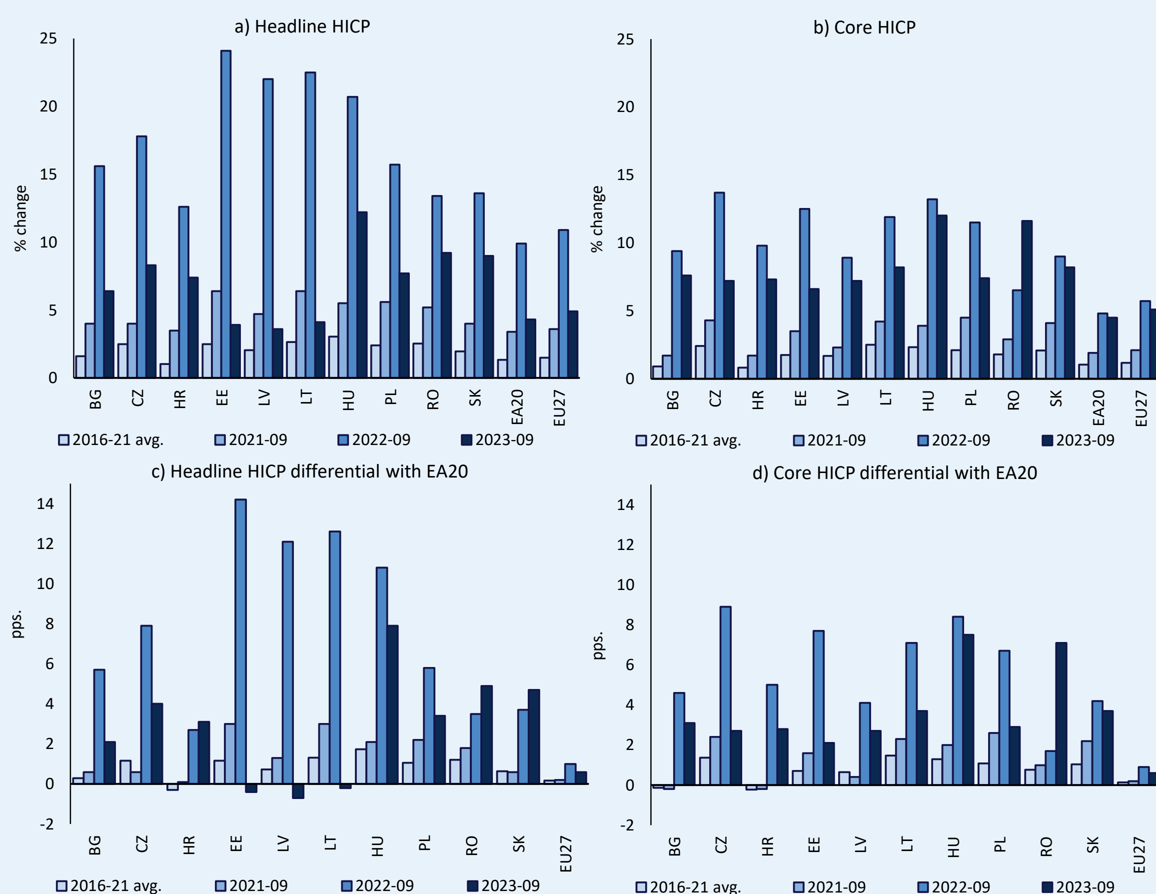
Higher unit profits have been major drivers of the inflation differentials vis-à-vis the euro area. Unit labour costs have visibly added to those differentials, except in Croatia, Romania and Slovakia (see Graph 3.2.3). Changes in imported energy prices have contributed in different ways, being insignificant or detracting from the differential vis-à-vis the euro area in the cases of Czechia, Estonia, and Romania (see Graph 3.2.3).

([30]) European Commission (2023), 'Inflation Differentials in Europe and Implications for Competitiveness: Thematic Note to Support In-Depth Reviews' (europa.eu), Institutional paper No. 198, April 2023.

According to the Commission forecasts, the prospects are for further accumulation in the inflation differentials in 2023 and in 2024. The cumulated effect of higher inflation in these countries will be a lasting shift in price levels, of double-digit magnitude apart from Croatia, over the years 2022 to 2024. In all these cases, in 2023, differentials are expected to continue being visibly positive, especially in Czechia, Hungary, Poland, and Slovakia (Graph 3.2.3). In 2024, the inflation differentials are forecast to turn negative in Croatia and to be essentially stable in Czechia, Latvia, and Lithuania, with a marginal increase in Estonia. Differentials will continue being positive in Bulgaria and Hungary, and more strongly so in Poland, Romania, and Slovakia.

With headline inflation decreasing in these countries, it is also important to maintain tight conditions and keep up the disinflationary efforts. Empirical evidence ([31]) shows that comebacks of inflationary episodes after premature retractions of the tight policies are very likely and are associated with periods of inflation plateauing at higher levels or re-accelerating. Evidence also points to less nominal depreciation and lower nominal wage growth (which does not necessarily imply negative real wage growth) as main factors towards a successful resolution of the inflationary episodes.

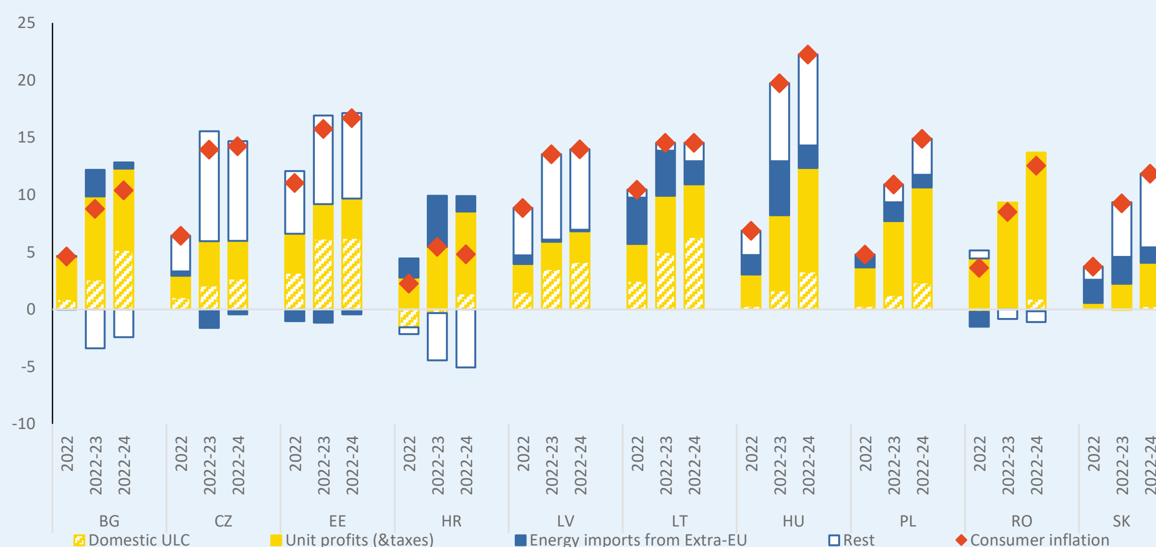
Graph 3.2.2: **Headline and core inflation and differentials with EA20 in selected countries**



Source: European Commission with Eurostat data

([31]) Ari, A., Mulas-Granados, C., Mylonas, V., Ratnovski, L., & Zhao, W. (2023). One Hundred Inflation Shocks: Seven Stylized Facts. IMF Working Paper WP/23/190.

Graph 3.2.3: **Inflation differentials decomposition with respect to the euro area, 2022-2024, cumulated**



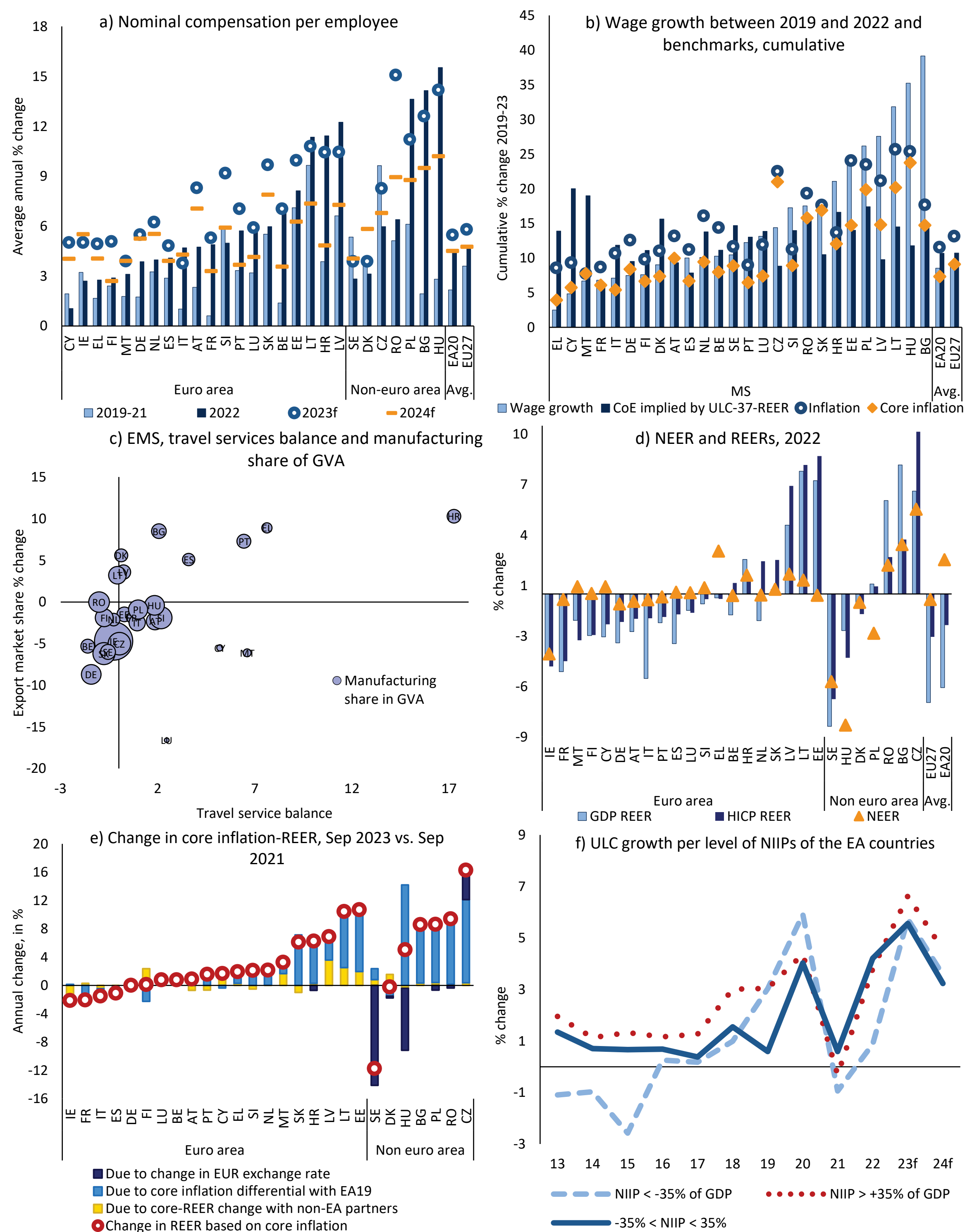
Source: European Commission. For methodology see European Commission (2023), 'Inflation Differentials in Europe and Implications for Competitiveness: Thematic Note to Support In-Depth Reviews' (europa.eu), Institutional paper No. 198, April 2023.

Table 3.2.1: **Heatmap: HICP and components, year-on-year percentage change**

	21-11	21-12	22-01	22-02	22-03	22-04	22-05	22-06	22-07	22-08	22-09	22-10	22-11	22-12	23-01	23-02	23-03	23-04	23-05	23-06	23-07	23-08	23-09	23-10
Bulgaria																								
HICP	6.3	6.6	7.7	8.4	10.5	12.1	13.4	14.8	14.9	15	15.6	14.8	14.3	14.3	14.3	13.7	12.1	10.3	8.6	7.5	7.8	7.5	6.4	
Core	2.8	2.7	3.6	4.1	5.3	6	6.7	7.7	8.3	8.8	9.4	9.8	10.3	11.1	11.1	10.9	10.8	10.7	9.7	9.2	9.9	9.1	7.6	
Services	3	2.4	3.5	3.9	5.6	6.5	7.4	8.8	9.7	9.7	10	10.2	11.2	12.1	11.4	11.2	11	11.5	9.8	9.2	10.6	9.6	7.5	
Food	5.5	6.9	8.5	10.6	13.4	16.4	18	19.1	19.5	19.8	20.7	21.8	22.2	21.7	21.1	20.5	18.6	14.9	13.5	12.7	12.4	11.5	10.1	
NEIG	2.3	2.9	3.8	4.3	5.1	5.7	6.1	6.7	7.1	8.1	8.9	9.3	9.5	10.2	10.8	10.7	10.5	10	9.6	9.2	9	8.3	7.6	
Energy	24	24.1	24.7	23	27.8	30	34.1	37.5	34.1	32	32.1	22.1	15.2	12.7	13.5	11.6	3.8	-0.7	-5.7	-9.6	-9.4	-6.9	-5.7	
Czechia																								
HICP	4.8	5.4	8.8	10	11.9	13.2	15.2	16.6	17.3	17.1	17.8	15.5	17.2	16.8	19.1	18.4	16.5	14.3	12.5	11.2	10.2	10.1	8.3	
Core	5.7	6.6	7.8	8.6	9.7	11.2	12.1	12.8	13.4	13.7	13.7	14	13.5	13.3	13.2	13.3	12.8	11.4	10.3	9.5	9.1	8.3	7.2	
Services	5	5.2	7	7.8	8.7	10.6	11.7	12.6	13.5	13.7	13.8	14.1	13.9	14.3	14.2	14.4	14.3	12.6	11.4	10.9	11	10.5	9.5	
Food	4.1	5	5.7	7	7.7	8.8	12.3	14.3	15.3	15.6	16.4	19.1	20	19.7	19.6	19.2	18.5	14.4	12.4	10.7	9.1	8	6.5	
NEIG	6.7	8.2	8.8	9.6	10.9	11.9	12.8	13.1	13.3	13.7	13.7	13.9	13	12.3	12	12	11.1	10.1	8.9	7.8	6.7	5.6	4.4	
Energy	2.7	1.7	21.4	25.1	33.2	34.7	37	40	40.4	36.8	41.3	14.2	27.8	25.8	41.9	36.9	25.6	23.4	20.3	17.5	16.1	20.6	14.9	
Croatia																								
HICP	4.7	5.2	5.5	6.3	7.3	9.6	10.7	12.1	12.7	12.6	12.6	12.7	13	12.7	12.5	11.7	10.5	8.9	8.3	8.3	8	8.4	7.4	6.7
Core	2	2.5	2.6	3.5	4.7	6.3	6.9	8.4	9.1	9.5	9.8	9.7	9.8	10.5	11.3	10.4	10	9.4	9.5	9.5	9.5	9.1	7.3	7.4
Services	1.9	2.3	2	2.7	3.7	5.9	6.1	7.9	9.4	9.6	9.3	9.5	9.5	9.9	11.4	11	10.6	10.1	10.7	11	10.8	10.7	9.2	9.2
Food	5.3	7.3	8.4	9.1	8.6	10.2	11.8	13.3	14.5	15.6	15.3	16	15.9	16	14.9	14.6	14.7	13.5	13.4	13.4	11.8	10.3	10	8.5
NEIG	2	2.9	3.3	4.5	5.7	6.7	7.8	9	8.5	9.2	10.4	9.9	10.2	11.2	11.1	9.7	9.1	8.5	8.1	7.7	7.7	6.9	4.8	5.4
Energy	15.6	12.4	11.9	12.3	15.8	23.1	25.4	25.8	24.2	19.3	18.5	19	20.3	14.7	12.5	11	4.3	-2.3	-7	-7.2	-5.8	1.4	2.8	-0.5
Estonia																								
HICP	8.6	12	11	11.6	14.8	19.1	20.1	22	23.2	25.2	24.1	22.5	21.4	17.5	18.6	17.8	15.6	13.2	11.2	9	6.2	4.3	3.9	5
Core	5.2	5.7	5.8	6.4	7.9	10.2	9	10.1	11.4	11.8	12.5	13	12.3	12.5	12.6	12.7	12.4	10.8	10.7	9.7	7.9	7.4	6.6	
Services	4.6	4.6	4.7	5.4	7	10.3	9.3	11.1	12.7	12.1	13.3	13.7	12.7	13.3	12.8	12.8	12.4	9.6	10.2	9.5	6.6	6.4	6	
Food	4.8	5.2	7.7	10.2	11.3	12.2	14.5	16.4	17.1	18.5	20.8	23.3	23.7	25	23.5	21.6	21.4	20.3	17.6	17	14.5	11.7	8.9	
NEIG	5.6	6.6	6.7	7.2	8.9	10	8.7	9.1	10	11.4	11.6	12.3	11.9	11.7	12.5	12.6	12.4	12	11.2	9.8	9.1	8.3	7.1	
Energy	33.6	57.9	41.4	36.7	53.8	76.9	86.4	89	89.1	100.1	79.6	60.9	53.9	23.4	33.3	31.1	17.2	10.3	3.2	-4.1	-10	-13.8	-10.6	
Latvia																								
HICP	7.4	7.9	7.5	8.8	11.5	13.1	16.8	19.2	21.3	21.4	22	21.7	21.7	20.7	21.4	20.1	17.2	15	12.3	8.1	6.6	5.6	3.6	2.4
Core	3.3	3.7	4.2	4.5	5.4	6	7.1	7.5	8.2	8.2	8.9	9.5	10.5	10.7	10.9	11.1	10.7	10.2	10.4	8.9	9	8.1	7.2	
Services	3.9	3.9	4.1	4.8	5.7	7	7.8	8.6	9.6	9.6	10.4	11.2	11.6	11.9	12.1	12	11.8	10.9	12.1	10.6	10.3	9.6	8.3	
Food	4.9	6.3	7.3	10.1	12.2	14.7	15.2	18.3	20	21.3	22.5	23.9	24.1	23.7	23.5	21.4	20.7	17.6	16	13.2	10.7	8.2	6.5	
NEIG	2.4	3.4	4.4	4.2	5.1	5	6.4	6.3	6.6	6.5	7.3	7.6	9.4	9.5	9.6	10	9.5	9.3	8.4	6.8	7.3	6.3	5.9	
Energy	29.5	27.4	19.2	20.4	31.3	34.1	55.1	63.7	70.2	67	65	56.5	51.7	45.3	50.7	45.9	28.9	23.2	10.4	-2.7	-5.5	-4.6	-9.8	
Lithuania																								
HICP	9.3	10.7	12.3	14	15.6	16.6	18.5	20.5	20.9	21.1	22.5	22.1	21.4	20	18.5	17.2	15.2	13.3	10.7	8.2	7.2	6.4	4.1	3
Core	5.7	6.4	7.3	8.3	9	9.4	9.9	10	10.9	10.9	11.9	12.2	12.7	12.6	12.3	12.1	12.1	11.7	10.9	10.2	10.1	9.4	8.2	
Services	7	7.3	8.8	9.7	10.4	11.2	11.9	12.6	12.7	12.8	13.6	14	14.6	14.1	13	12.5	12.4	12.6	12	11.5	11.7	10.9	8.9	
Food	6.8	9	11	13.5	15	18.5	20.5	23.6	24.4	24.7	24.7	27.2	28.5	28.2	26.7	24.8	23.3	18.8	16.2	13.3	12.2	11	8.7	
NEIG	4.7	5.8	6.2	7.2	8	8	8.4	8.1	9.5	9.5	10.6	10.8	11.3	11.6	11.8	11.7	11.8	11	10.1	9.2	8.9	8.4	7.7	
Energy	36.3	38.9	43	46.1	51.8	50.7	61.1	71.7	65.8	65.9	73.1	60.3	47.8	36.7	29.1	24.2	12.3	8.6	-1.1	-9	-13.3	-13.5	-18.3	
Hungary																								
HICP	7.5	7.4	7.9	8.4	8.6	9.6	10.8	12.6	14.7	18.6	20.7	21.9	23.1	25	26.2	25.8	25.6	24.4	21.9	19.9	17.5	14.2	12.2	
Core	5	5.5	6.1	6.7	7.4	8.2	9.1	9.6	11	12.3	13.2	14	14.8	15.4	16.4	16.6	17.4	17.4	16.5	15.6	14.6	13.2	12	
Services	5.2	5.6	6.1	6.5	7.2	7.9	8.8	8.8	10.3	11.5	12.5	13.2	14.1	15.1	16.6	17.1	18.4	19.1	18.8	18.2	17.8	16.3	15.2	
Food	7.1	7.9	9.2	10.3	11.2	12.5	15.2	18	23.2	26.8	29.9	33.5	36.7	37.2	37.3	37.7	37.3	33.7	29.9	26.4	19.9	16.4	13	
NEIG	4.8	5.5	6.2	6.8	7.5	8.5	9.5	10.6	11.8	13.1	14.1	15	15.6	15.7	15.9	16	15.8	15	13.3	12	10.1	8.8	7.6	
Energy	21	14.9	13.2	11.2	7.3	8.1	7	11.8	8.9	27.3	32	28.3	27.1	38.7	43.9	39	34.7	33.5	26.3	22	23.6	10.8	9.1	
Poland																								
HICP	7.4	8	8.7	8.1	10.2	11.4	12.8	14.2	14.2	14.8	15.7	16.4	16.1	15.3	15.9	17.2	15.2	14	12.5	11	10.3	9.5	7.7	
Core	5.4	5.8	6.6	7.1	7.8	8.6	9.4	9.9	9.9	10.7	11.5	11.7	12	12	11.9	11.8	11.6	11.3	10.4	10.1	9.5	8.9	7.4	
Services	7.1	7.5	8.7	9.4	10	11.1	12	12.5	12.8	13.1	13.9	14.3	14.4	14.5	13.7	13.3	13	12.6	11.6	11	10.4	10.2	9.2	
Food	5.1	6.8	7.5	6.5	7.8	10.1	10.8	11.3	12.3	14.2	15.7	18	18.3	17.8	17.4	20.4	21	18.3	17.9	17.3	15.5	13	11.3	
NEIG	3.9	4.2	5	5.2	5.7	6.4	7.2	7.9	7.5	8.7	9.5	9.5	9.9	10	10.1	10.3	10.6	10.1	9.5	9	8.6	7.5	5.7	
Energy	21.8	21.2	20.2	15.3	26.6	26.6	32.2	38.8	36.4	33.5	34.3	33.7	29.5	25.3	30.6	36.1	19.9	17.7	11	4.9	5.1	6.5	3	
Romania																								
HICP	6.7	6.7	7.2	7.9	9.6	11.7	12.4	13	13	13.3	13.4	13.5	14.6	14.1	13.4	13.4	12.2	10.4	9.6	9.3	8.9	9.3	9.2	
Core	3.5	3.4	4	4.2	4.6	5	5.4	5.8	6.2	6.2	6.5	7.1	8	8.4	8.6	8.9	8.4	8.4	8.7	9	9.1	11.4	11.6	
Services	4.3	3.9	4.7	4.9	5.2	5.6	5.9	6.2	6.6	6.6	6.6	7.1	8.1	8.4	8.6	8.8	9.4	9.5	9.9	10.2	10.5	10.6	10.9	
Food	6.2	6.6	7.2	8.8	10.9	12.9	13.6	13.8	14.9	16.8	17.3	18.8	19.6	20	20.4	20.2	19.7	18.1	17.1	16.6	15.3	11.1	9.7	
NEIG	2.9	3	3.4	3.7	4.1	4.6	5	5.5	5.8	6	6.4	7.2	7.9	8.4	8.6	8.9	7.6	7.6	7.7	8	7.9	12	12.1	
Energy	26.6	25	24.1	23.3	29.4	39.9	42.5	45	37.9	34.6	32.7	24.1	27.6	21.1	13.6	12.1	5.8	-2.4	-6.4	-8	-7.6	-3	-1	
Slovakia																								
HICP	4.8	5.1	7.7	8.3	9.6	10.9	11.8	12.6	12.8	13.4	13.6	14.5	15.1	15	15.1	15.4	14.8	14	12.3	11.3	10.3	9.6	9	7.8
Core	5	5.2	5	5.5	6.9	8.1	8.5	8.8	8.9	9.4	9	9.3	9.5	9.8	11.3	11.9	11.7	11.4	10.3	10.1	9.2	8.6	8.2	7.8
Services	6.3	6.5	6.2	6.6	8.6	9.9	10.2	10.4	10.4	11.2	9.3	9.2	9.7	9.9	12.3	13.2	12.5	12.3	10.3	10.2	9	8.7	8.8	9
Food	5.2	6.2	8.4	9.4	10.1	11.9	13.6	15.3	16.2	17.9	19.8	22.1	23.9	24.1	23.6	23.9	24	22	19.1	16.9	15.2	12.7	10.9	8.9
NEIG	3.9	4	3.9	4.5	5.4	6.5	7	7.3	7.6	7.8	8.7	9.4	9.4	9.7	10.4	10.5	10.8	10.6	10.3	10	9.4	8.4	7.5	6.7
Energy	3.1	2.1	16.5	16.4	18.2	19	20.3	21.7	20.6	19.3	18.8	19	18.6	17	12.5	12.1	9.1	8.2	6.3	4.9	5.1	7.4	7.9	5.5
Euro area																								
HICP	4.9	5	5.1	5.9	7.4	7.4	8.1	8.6	8.9	9.1	9.9	10.6	10.1	9.2	8.6	8.5	6.9	7	6.1	5.5	5.3	5.2	4.3	2.9
Core	2.6	2.6	2.3	2.7	3	3.5	3.8	3.7	4	4.3	4.8	5	5	5.2	5.3	5.6	5.7	5.6	5.3	5.5	5.5	5.3	4.5	4.2
Services	2.7	2.4	2.3	2.5	2.7	3.3	3.5	3.4	3.7	3.8	4.3	4.3	4.2	4.4	4.4	4.8	5.1	5.2	5	5.4	5.6	5.5	4.7	4.6
Food	2.2	3.2	3.5	4.2	5	6.3	7.5	8.9	9.8	10.6	11.8	13.1	13.6	13.8	14.1	15	15.5	13.5	12.5	11.6	10.8	9.7	8.8	7.5
NEIG	2.4	2.9	2.1	3.1	3.4	3.8	4.2	4.3	4.5	5.1	5.5	6.1	6.1	6.4	6.7	6.8	6.6	6.2	5.8	5.5	5	4.7	4.1	3.5
Energy	27.5	25.9	28.8	32	44.3	37.5	39.1	42	39.6	38.6	40.7	41.5	34.9	25.5	18.9	13.7	-0.9	2.3	-1.8	-5.6	-6.1	-3.3	-4.6	-11.1
EU 27																								
HICP	5.2	5.3	5.6	6.2	7.8	8.1	8.8	9.6	9.8	10.1	10.9	11.5	11.1	10.4	10	9.9	8.3	8.1	7.1	6.4	6.1	5.9	4.9	
Core	2.9	3	2.8	3.3	3.6	4.1	4.5	4.6	4.9	5.2	5.7	6	6	6.2	6.3	6.6	6.6	6.5	6.1	6.2	6.2	5.9	5.1	
Services	3.1	2.9	2.9	3.1	3.3	4	4.3	4.3	4.7	4.7	5.2	5.3	5.3	5.5	5.4	5.8	6	6.1	5.9	6.2	6.3	6.1	5.4	
Food	2.9	3.9	4.3	5	5.9	7.4	8.6	9.9	11	12	13.1	14.7	15.2	15.3	15.5	16.6	16.9	14.7	13.7	12.7	11.6	10.2	9.1	
NEIG	2.6	3.1	2.6	3.5	3.9	4.3	4.8	5	5.2	5.9	6.3	6.9	7	7.3	7.5	7.5	7.4	7	6.5	6.2	5.7	5.4	4.7	
Energy	25.9	24.6	27	28.7	40.2	35.6	37.7	41.1	38.3	37.5	39.4	38.7	33.3	25.5	20.6	16.6	2.6	4.4	-0.3	-4.1	-4.4	-2	-3.6	

Source: Eurostat, European Commission

Graph 3.2.4: **Selected graphs on competitiveness**



Note: Panel b: 'CoE implied by ULC-37 REER' is the percentage change in the compensation per employee that would have left constant the REER based on ULC between 2019 and 2023. Panel e: Commission calculations using the underlying double export weights provided by DG ECFIN's NEER (link: https://economy-finance.ec.europa.eu/economic-research-and-databases/economic-databases/price-and-cost-competitiveness/price-and-cost-competitiveness-data-section_en), and the following inflation rates: HICP excluding food and energy for countries covered by Eurostat, the BLS urban CPI excl. food and energy for the US, e-stat "core-core" inflation for Japan, and IMF CPI excluding the food, beverages, tobacco, housing, water, electricity, gas and other fuels, for all other countries.
Source: Eurostat and European Commission calculations

3.3. NON-FINANCIAL CORPORATIONS

Non-financial corporate (NFC) debt-to-GDP ratios continued to decrease in 2022, but remained sizeable in many EU countries. The EU and euro area average debt ratios decreased by 5 percentage points in 2022, to 78% of GDP and 80%, respectively. Both aggregates returned to close to their pre-pandemic level (Graph 3.3.1 a) ([32]). The corporate debt ratio decreased in nearly all countries in 2022, reflecting high inflation and, in nearly all cases real GDP growth (Graph 3.3.3 a). Corporate net credit flows were positive and increasing in almost all Member States in 2022, including in some with high debt ratios. Nonetheless, in 2022, debt ratios remained above levels suggested by both economic fundamentals and by levels related to prudential concerns in almost half of the EU countries.

Deleveraging is continuing at lower pace so far in 2023, driven by decelerating credit flows and high inflation ([33]). In the first half of 2023, corporate debt-to-GDP ratios continued to decline, driven by high inflation and moderating credit flows (Graph 3.3.3 b and Graph 3.3.3 c). The contribution of real GDP growth to deleveraging has weakened, reflecting a slowdown in economic activity in the first half of 2023. If trends observed over the first half of 2023 persist, with high nominal GDP growth, mostly on account of still high inflation, and moderate credit flows, corporate debt deleveraging is set to continue. In almost all EU countries with high or very high corporate debt ratios, deleveraging is expected to be extensive, reaching several percentage points in 2023.

In the future, deleveraging could become more challenging, as credit conditions remain tight and the macroeconomic environment remains subdued. Inflation should remain elevated for a while, which would continue to support passive deleveraging. The high and increasing share of corporate loans with a revision of the interest rates within the next 24 months implies that the rise in interest rates can rather quickly translate into an increasing interest payment burden for corporates ([34]). Overall, credit standards remain tight by historic standards, despite some loosening since spring 2023 (Graph 3.3.3 e). Tighter financing conditions could slowdown corporate investment and credit demand in the future (Graph 3.3.3 f). With the continuously subdued macroeconomic environment, these tendencies could undermine some corporates' ability to meet their interest payments and make further deleveraging efforts of companies more difficult.

The composition of corporate debt can affect vulnerabilities associated to high debt stocks, through its ownership structure and currency denomination. Debt holdings by foreigners with low associated domestic risks, such as liabilities linked to foreign direct investment inflows, represent a sizeable share of corporate debt in some countries with particularly high debt stocks. While such foreign debt holdings reduce domestic corporate vulnerabilities, they also imply

([32]) Country-specific debt benchmarks have been developed by the European Commission in cooperation with the EPC LIME Working Group (European Commission, 'Benchmarks for the assessment of private debt', Note for the Economic Policy Committee, ARES (2017) 4970814) and J.-C. Bricongne, L. Coutinho, A. Turrini and S. Zeugner, 'Is Private Debt Excessive?', Open Economies Review, 3, 471-512, 2020. Fundamentals-based benchmarks assess private debt from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. Prudential thresholds represent the debt level beyond which the probability of a banking crisis is relatively high by minimising the probability of missed crisis and of false alerts.

([33]) European Central Bank (2023), Financial Stability Review, May 2023

([34]) European Central Bank (2023), Financial Stability Review, May 2023, based on the Bank lending Survey, first quarter of 2023.

higher cross-border contagion risks from an EU and a euro area perspective ([35]). A high share of corporate loans denominated in foreign currency exposes the debt holder to additional exchange rate risks ([36]). It therefore represents a source of additional vulnerabilities in some countries, particularly some outside the euro area and when they do not have revenues recorded in the currencies in which they borrow.

Unit profits have increased substantially until 2022, but the sharp increase in interest rates has resulted in deteriorating interest coverage ratios ([37]). Unit profits benefited from higher pricing power in a context of high inflation and supply shortages affecting the production process. This, along with accumulated liquidity, helped NFCs to repay their debts in 2022. Unit profit growth decelerated in the first two quarters of 2023, with the economic slowdown and strong wage growth (Graph 3.3.1 b). The recent steep increase in funding costs dents net incomes and has resulted in an overall deterioration of the interest coverage ratio of firms (Graph 3.3.3 d). Highly leveraged firms experienced a particularly marked decline in their interest coverage and have far lower profit margins than firms with lower debt levels which makes it more difficult for them to deleverage ([38]). The build-up of inventories could reflect preventive action by firms in response to the sharp increase in input prices.

Although corporate non-performing loans ratios remain low in most countries, bankruptcies have started to increase in some cases ([39]). Corporate non-performing loans ratios continued to decline in almost all Member States in 2022. Business bankruptcies, although they remain low compared to the years before the COVID-19 pandemic, have been increasing, at accelerating pace, in the first half of 2023. Bankruptcies increased particularly strongly in the accommodation and food and the transport sectors (Graph 3.3.2 b). Instead, new business registrations remain at an elevated level compared to the pre-COVID period, although the number decreased in some countries in the first half of 2023. At industry level, some differences are worth highlighting, including the increase in vulnerabilities in manufacturing and commercial real estate, as compared to the services sector (Box 3.3.1, see also Section 3.6).

The investment activity of non-financial corporates is decelerating, which, if persistent, may undermine overall economic growth and corporates' ability to repay their pre-existing debts. Corporate investment, as share of GDP, recovered gradually after the COVID-19 crisis (Graph 3.3.3 f). However, at 23.7% of GDP for the EU in the second quarter of 2023, it remains below pre-pandemic levels and broadly unchanged compared to the end of 2022. The recent increase in energy prices boosted green investment, while reducing the funds available for

([35]) Plamen Nikolov, 2016. 'Cross-border risk sharing after asymmetric shocks: evidence from the euro area and the United States', Quarterly Report on the Euro Area (QREA), Directorate General Economic and Financial Affairs (DG ECFIN), European Commission, vol. 15(2), pages 7-18, July.

([36]) At the end of 2022, the share of non-financial corporate loans denominated in foreign exchange was very high and above 25% a number of non-euro area countries, including Poland, Hungary, Bulgaria, Romania and Czechia. In Ireland, Sweden and Luxembourg this share was at around 10%.

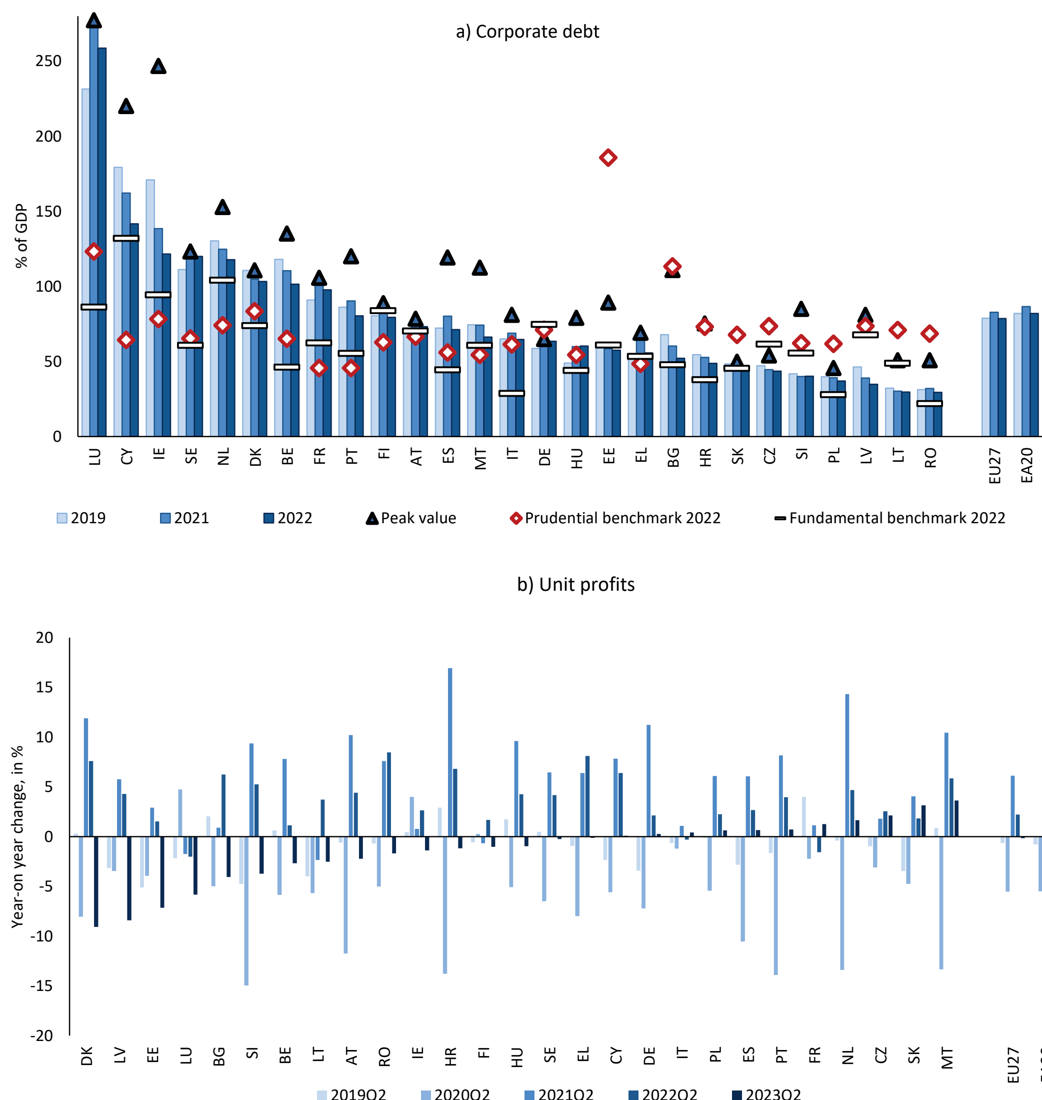
([37]) The interest coverage ratio is defined as the ratio of gross operating surplus to gross interest payments before the calculation of financial intermediation services indirectly measured (FISIM). The ratio is a measure of the ability of the non-financial corporate sector to pay the interest on its outstanding debt (European Central Bank (2022), Financial Stability Review, November 2022..

([38]) European Central Bank (2022), Financial Stability Review – May 2022. Data for 2021. https://www.ecb.europa.eu/pub/pdf/fsr/ecb.fsr202205~f207f46ea0.en.pdf

([39]) Non-performing loans and bankruptcy data are typically considered to be backward-looking data. As usually some time passes until a company in difficulty repays debt with a delay or files bankruptcies. This backward-looking tendency was strengthened during the COVID-19 pandemic through corporate debt moratoria that were introduced in many Member States.

investment spending [40]. In the future, high uncertainty, rising interest rates, and still high credit standards are likely to weigh on corporate investment activity. Investment of firms with high debt stocks is likely to be affected particularly strongly [41]. A persistent decline in the investment rate of corporates in light of the continuously high uncertainty would undermine their growth potential and capacity to repay the pre-existing debt (Graph 3.3.3 f).

Graph 3.3.1: **Non-financial corporate debt and unit profits**



Corporate debt includes loans (F4) plus debt securities (F3) as defined in the financial balance sheet accounts. Corporate debt is consolidated, which means that transactions within the same sector are excluded. The peak value in Panel A is based on data since 1997, upon availability. Unit profit growth in Pan el B is calculated as profits divided by sectoral value added (profits = value added minus compensation of employees).
Source: AMECO, Eurostat and Commission estimates.

[40] European Investment Bank (2023), Investment Report 2022/2023 - Resilience and renewal in Europe, Luxembourg.

[41] Corporate indebtedness implies higher interest expenses and thus less money available for investment. Firms with high debt also find it harder to obtain new funds from external sources due to their higher default risk. Moreover, the desire to repair weak balance sheets leads firms to reduce their debt burden, and thereby forgo investment opportunities. European Central Bank (2023), How high corporate debt stifles investment, The ECB Blog, 8 January 2023. 2023https://www.ecb.europa.eu/press/blog/date/2023/html/ecb.blog230118~0eb37005b7.en.html

The risks associated with more difficult economic conditions, combined with ongoing structural changes, can have differentiated effects within the euro area. Tightening financing conditions are likely to hit particularly countries with high debt stocks or where non-performing loans are higher, which can hamper investment and convergence. In some countries, the denominator effect can play a stronger role and support passive deleveraging, in the current high inflation environment. Some countries with a strong industrial base may need to finance structural transformations, which would need to be accompanied by effective policies to avoid excessive adjustment costs, including through rising insolvencies. Financial conditions and available fiscal space might eventually play a role in the possible scale and scope of national interventions. A divergence in corporate investment could over time lead to competitiveness and growth differentials in the euro area.

Box 3.3.1 Selected corporate vulnerabilities at industry level

This box provides a brief overview of vulnerabilities across selected industries. It draws on publications by the European Commission, the European Central Bank, and the European Systemic Risk Board.

Vulnerabilities associated with the commercial real estate sector are increasing, with the demand for office and commercial space decreasing and financing conditions tightening ([42]). Bank lending survey data suggest that the commercial real estate sector in the euro area is sizeable and accounts for up to one third of total bank loans to corporates, despite the substantial moderation in lending activity ([43]). Despite the decline in credit witnessed since the end of 2022, the commercial real estate sector continued to contribute strongly to the growth in bank loans (Graph 3.3.2a). While bankruptcies among commercial real estate exposed non-financial firms remain low, the share of vulnerable NFC loans in the commercial real estate has likely increased due to declining asset prices, falling investor demand, and residual vulnerabilities persisting from the pandemic (see also Section 3.6) ([44]). The European Systemic Risk Board recently also highlighted vulnerabilities in the commercial real estate sector ([45]).

The currently witnessed transformations in industry in some Member States could be structural and part of necessary adjustment processes but may also increase vulnerabilities ([46]). The challenges associated with structural adjustments that accelerated during the COVID-19 pandemic and the energy crisis outbreak in 2022 can have widespread effects on the productive capacity and potential growth of industry. Confidence evolved less favourably in industry than in the service sector throughout 2023, and bankruptcies increased, although they remain below pre-pandemic levels ([47]). While the share of value added in industry for the EU decreased in 2022, it started to recover in the first half of 2023. Employment remained broadly stable in the first half of 2023, but is lower than before the COVID-19 pandemic. The growth in unit

([42]) Ryan, Ellen & Horan, Aoife & Jarmulska, Barbara, 2022. 'Commercial real estate and financial stability – new insights from the euro area credit register', Macroprudential Bulletin, European Central Bank, vol. 19.

([43]) According to the ECB Bank Lending Survey, bank lending to corporates in the sectors real estate, professional services and administration (LMN) accounted for about one third of bank lending to corporates and 38% of GDP in the first half of 2023.

([44]) European Central Bank (2023), Financial Stability Review, May 2023.

([45]) In January 2023, the European Systemic Risk Board issued a recommendation on vulnerabilities in the CRE sector in the EEA, which encompass both cyclical and structural factors: Recommendation of the European Systemic Risk Board of 1 December 2022 on vulnerabilities in the commercial real estate sector in the European Economic Area (ESRB/2022/9) 2023/C 39/01

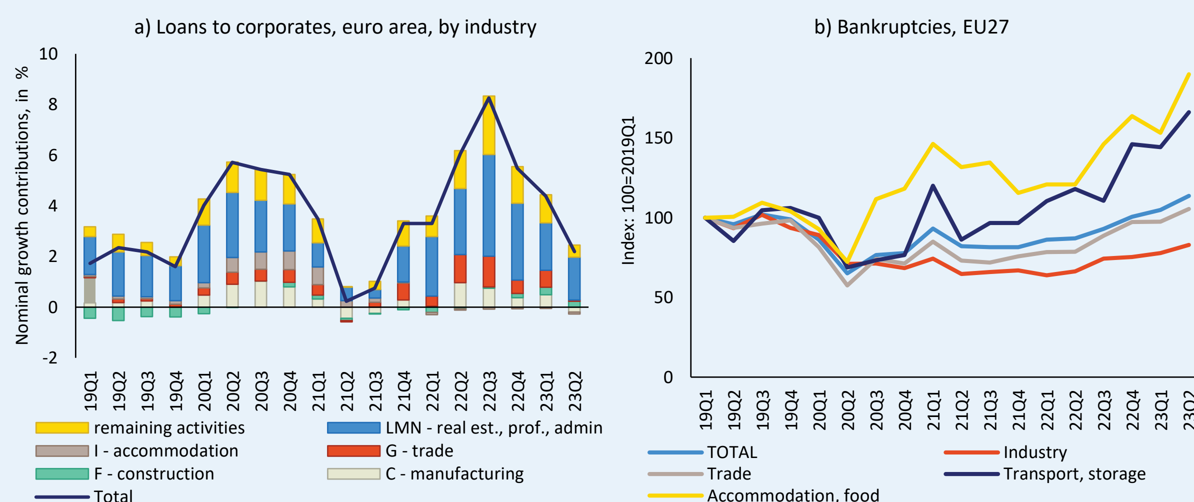
([46]) Industry includes (B) mining and quarrying, (C) manufacturing, (D) Electricity, gas, steam and air conditioning supply; and (E) water supply, sewerage, waste management and remediation activities.

([47]) European Commission, Business and consumer surveys.

profits in industry decelerated in the first half of 2023, after high growth in 2021 and 2022 ([48]). If input costs become permanently higher, a loss of competitiveness could materialise.

The service sector overall continues to benefit from a strong recovery of tourism after the COVID-19 pandemic in several Member States, although the number of bankruptcies continues to increase. The tourism sector performed strongly in the first half of 2023. Value added in tourism services contracted significantly in the fourth quarter of 2022, but started to increase again in the second quarter of 2023. In the first two quarters of 2023, confidence in services performed better than in the manufacturing sector. The number of bankruptcies continued to be high and increased further in the first half of 2023, pointing to some structural adjustments in some service sectors (Graph 3.3.2 b).

Graph 3.3.2: **Corporate loan growth contributions and bankruptcies, by industry**



Panel a: Loans granted to euro area non-financial corporations by the euro area monetary financial institution (MFI) sector, broken down by economic activity in accordance with NACE Rev. 2.
Source: ECB, Eurostat.

Countries with non-financial corporate debt to GDP ratios above fundamental and prudential thresholds in 2022 in blue																										
BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE

At country level, the following developments are worth highlighting:

- Non-financial corporate debt is very high, at close to or above 100% of GDP, in **Denmark** and **Sweden** (Graph 3.3.1 a). Unlike in Denmark, the corporate debt-to-GDP ratio in Sweden has remained broadly unchanged in recent quarters and is above its pre-pandemic level, with the corporate real estate sector showing vulnerabilities. In both countries the interest rate burden is high and has increased recently.

- Non-financial corporate debt is also very high, at close to or above 100% of GDP, but decreasing in **Belgium**, **Cyprus**, **Ireland**, **Luxembourg**, and **the Netherlands**. However, a high share of foreign direct investment loans and cross-border intracompany borrowing partly

([48]) European Commission (2023), Spring Forecast 2023.

limits vulnerabilities in these countries. In Ireland, vulnerabilities are further mitigated by particularly high and increasing profits. In Luxembourg, the corporate debt-to-GDP ratio is still above its pre-pandemic level, but net credit flows are negative. Belgium is characterised by a particularly high and increasing interest rate burden.

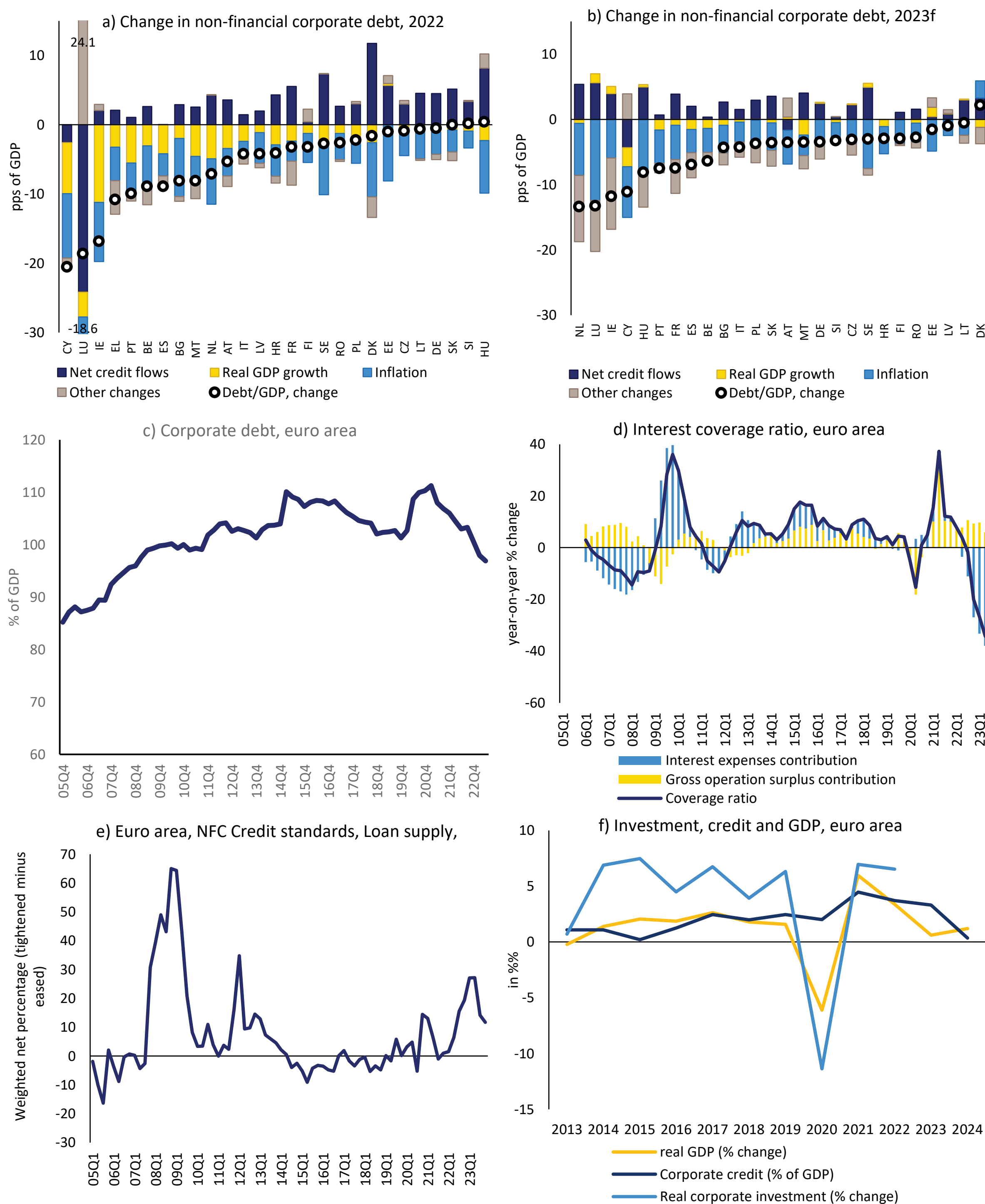
- High non-financial corporate debt-to-GDP ratios have been declining in **Austria, France, Malta, Portugal**, and **Spain**. In Spain, bankruptcies continued to increase in the first half of 2023, although starting from low levels. In France the debt ratio remains higher than before the COVID-19 pandemic, but credit flows have recently started to slow down significantly.

- In **Bulgaria**, **Estonia** and **Hungary**, the non-financial corporate debt-to-GDP ratio is high compared to regional peers. The debt ratio decreased in Bulgaria in 2022. In Hungary the debt ratio remained broadly unchanged and well above its pre-pandemic level. The interest rate burden in Hungary increased more than in most other EU countries. A substantial share of debt denominated in foreign currency represents an additional risk factor in Hungary.

- In **Greece**, the non-financial corporate debt-to-GDP ratio has declined to moderate levels in recent years, but the non-performing loans ratio is still high, albeit decreasing rapidly. High corporate liquidity buffers mitigate risks.

- In **Germany**, the non-financial corporate debt-to-GDP ratio is moderate, but vulnerabilities seem to increase. The energy crisis disproportionately affected energy-intensive industries, entailing vulnerabilities associated to potential structural changes, rising interest rates and a loss of real incomes. Construction investment has been muted. At the same time, equipment investment remained robust.

Graph 3.3.3: **Selected graphs on non-financial corporations**

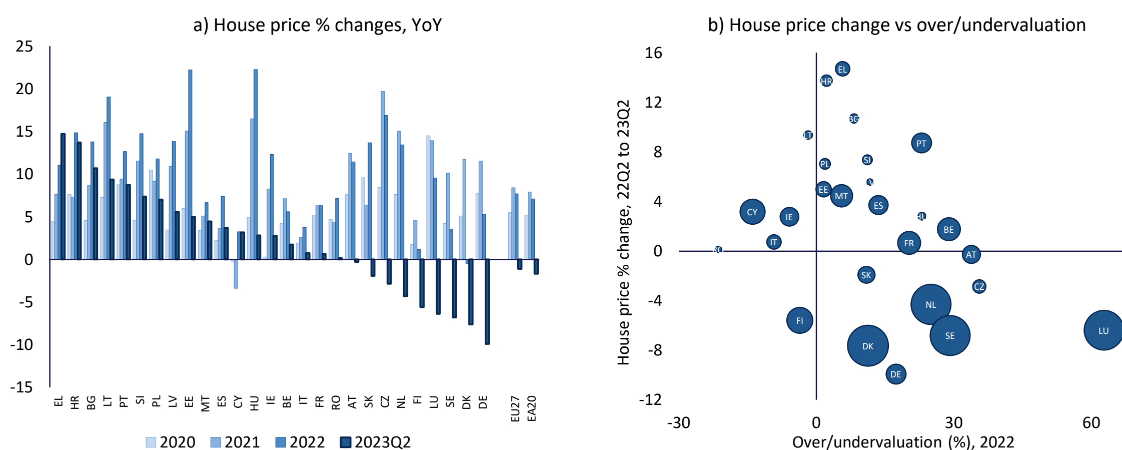


Net credit flows (debt transactions) correspond to transaction of loans (F4) and debt securities (F3) from the Eurostat sectoral financial transactions accounts. Real corporate investment for the euro area excludes Malta due to data limitations. The interest coverage ratio is defined as the ratio of gross operating surplus to gross interest payments before the calculation of financial intermediation services indirectly measured.
Source: AMECO, Eurostat, ECB.

3.4. HOUSING MARKETS

House prices grew strongly in 2022 overall, but within the year housing markets began to slow. In most Member States, the pandemic and immediate post-pandemic period saw strong increases in many countries' overvalued housing markets, building on years of house price growth exceeding household incomes (see Graph 3.4.1 a). House prices continued to accelerate in the early months of 2022, before beginning to moderate as mortgage interest rates increased and high inflation put pressure on household disposable income. In most EU countries, the moderation resulted in lower – but overall, still substantial – nominal house price growth compared to 2021. In some other cases, primarily countries with very high inflation rates in 2022, house prices grew even more strongly than in 2021. By the end of last year, house price growth had come down on a quarter-on-quarter basis in all but two countries and in two cases it had even turned negative. In the euro area as a whole, house prices grew by 9% on average over the year, which represents a slight deceleration relative to 2021 and hides strong in-year variation. By the end of 2022, house prices were estimated to be overvalued in three quarters of EU countries, with more than half of the countries displaying overvaluations of between 10-60% (see Graph 3.4.1 b).

Graph 3.4.1: **House price evolution, over/undervaluation and household debt**



(1) The bubbles in Panel b refer to household debt as % of household income.
Source: Eurostat and European Commission

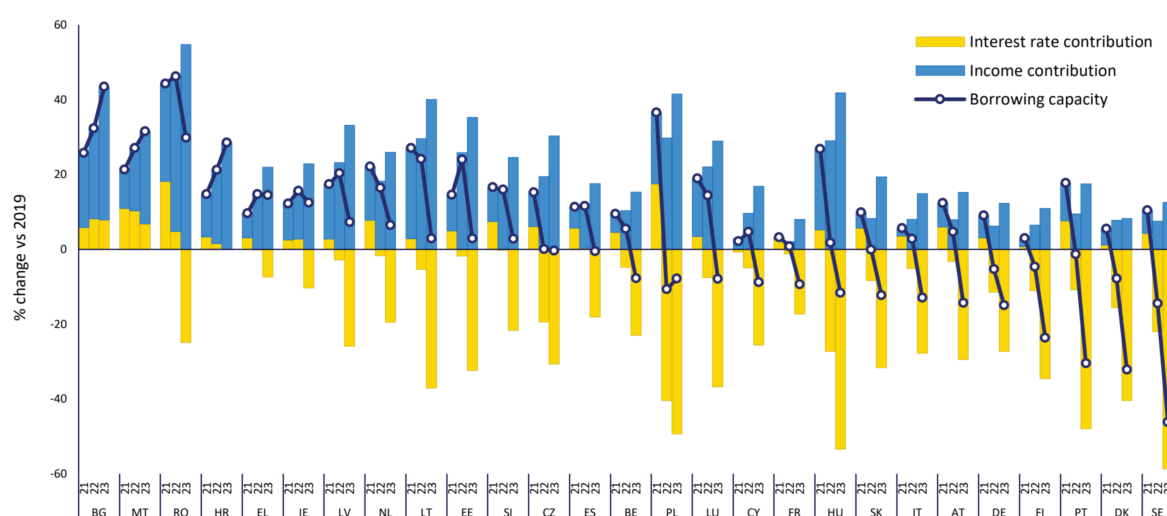
The moderation in house price growth continued in 2023, with more EU countries displaying declines in house prices, but housing markets remain overvalued in many countries. In-year data show a continuation of the reduction in house price growth rates in 2023 as the housing markets continue to adapt to high interest rates and household incomes continue to be affected by inflation. Negative house price growth has been recorded in one quarter of EU countries. Countries that have seen house price falls are primarily those with high overvaluations and high household debt (Graph 3.4.1 b). In most countries this reduction started within the year to the second quarter of 2023, so the overall fall from the peak has been greater. House prices have also fallen in the euro area on aggregate and there is marked difference in the overall country contributions to the euro area developments (Graph 3.4.3 e). Compared with the global financial crisis of 15 years ago, the biggest increases – and subsequent falls – were among countries that were not those affected before the global financial crisis 15 years ago. House price overvaluation has started to ease in many of the countries, although the reductions so far are limited and housing markets remain overvalued in many countries.

The increase of interest rates has triggered a reduction in loan demand for house purchases and in housing transactions in 2022 and 2023, affecting house prices. Monetary tightening both within and outside the euro area has translated into higher mortgage rates for new mortgages. This is particularly marked for some non-euro area countries, although not for all of them (Graph 3.4.3 b). Existing mortgage payments have also increased in some countries, with some delay depending on the fixation period of mortgage interest rates. The resulting reduced borrowing capacity of households has reduced demand for mortgage credit (Graph 3.4.3 c) and had an impact on house prices from mid-2022 in most Member States. This has also resulted in a big fall in housing transactions (Graph 3.4.3 d).

The borrowing capacity of households ([49]) fell in most countries in 2022, and is due to fall further in 2023, affecting house prices. Graph 3.4.2 presents the change in the borrowing capacity of households for 2021, 2022 and 2023 compared with 2019. It shows that in around half of countries the borrowing capacity in 2022 was below that in 2021, and in 2023 it is set to fall further in all but three countries. In some cases, the impact of the interest rate contribution is so substantial that it reduces the borrowing capacity of households by 30-50%. While the borrowing capacity of households is different from house prices, it offers a stylised approach to estimating how demand for housing may be affected by household incomes and interest rates. In countries where loan maturities are longer and house prices most overvalued, the impact of interest rates on house prices so far has been faster and more pronounced, while countries with shorter interest rate fixation periods and variable rates have experienced a faster transmission into existing mortgage payments. In EU countries outside the euro area, the impact of the increase in interest rates on house prices has been very strong overall, as interest rates have risen earlier and by more than in the euro area, although they have not risen in a small number of countries.

([49]) For a definition and methodology, see notes under Graph 3.4.2.

Graph 3.4.2: **Borrowing capacity change (%), vis-à-vis 2019**



(1) Borrowing capacity reflects the evolution of house prices that credit constrained households can afford by devoting a constant share of their income to mortgage payment at the origination of the mortgage. (2) Data used for computing borrowing capacity is median household income, interest rates and country-specific loan maturity. For loan maturity is used the average of maximum maturity, available in Grünberger et al. (2023): Housing taxation database 1995-2021, European Commission, Joint Research Centre (JRC). LTV ratio considered is 100% and other variables, like taxation, tax relief and transaction costs were fixed to zero to capture only the impact of income and interest rates on borrowing capacity. (3) For more detailed methodology see Andrle, M. and M. Plašil (2019): Assessing House Prices with Prudential and Valuation Measures. IMF Working Paper No. 19/59.
Source: Eurostat, ECB, AMECO, JRC, European Commission

A further correction of house prices is expected, particularly in countries where sustained price increases were associated with low interest rates. The current moderation or correction of house prices is expected to continue in 2023, as the mortgage rates should remain high this year and housing markets have not yet fully adjusted to the constraints faced by (new) borrowers. The most overvalued countries have typically seen house prices grow faster than incomes over the last decade, with a further acceleration during the pandemic. Where house purchases have been reliant on high household borrowing amid low interest rates, a correction in prices, which may cause some economic disruptions, can be expected. For a number of other countries, house prices grew in line with income before the pandemic, but house price growth was very high and significantly surpassed the evolution of incomes in recent years, drawing on excess accumulated liquidity. In these countries where overvaluation is limited or recent, and where inflation and wage growth continue to be strong, it is more likely that any correction will be overall less significant economically.

A sharp and sizeable correction of house prices with significant spillovers to other sectors is unlikely for most Member States, although some economic effects may be felt. Structural factors that led to sustained increases in house prices, often relating to tight supply, remain in place , and may be exacerbated by input cost increases in some cases. These should reduce the scope for more muted demand, translating into lower prices, instead leading to fewer transactions, possibly affecting the construction sector. Compared with the global financial crisis, the risks to the economy from a substantial downward adjustment of house prices are somewhat mitigated by lower weights of the sector in the economy and by macroprudential measures that limited the pace of mortgage credit growth in the last decade in most countries. However, in some cases, there are substantial risks associated with the ability of households to meet mortgage payments, resulting in both reduced consumption and loan repayment difficulties.

Despite the current downturn in housing markets, there are still risks associated with rising prices. Despite the increase in nominal interest rates, real interest rates remain negative – in some countries deeply so – providing an incentive for increased demand for housing with an investment perspective once the short-term jitters in the markets work their way through. In some regional markets, in particular in city centres and coastal areas, housing demand is also being driven by tourism, which is strongly recovering, and the high yields provided by short-term rentals. Therefore, countries affected by these factors may continue to see price growth in the future. This can be seen as a risk factor for a future sharper correction if economic conditions were to deteriorate. For some countries, increased current account deficits are associated with increases in construction for investment purposes. The possibility of housing bubbles funded by external capital flows and resulting in increased consumption needs to be carefully monitored. Finally, in some cases house prices may not seem to be overvalued using methodologies that capture the extent to which house prices are out of line with fundamentals, but they may still be very high when measured against incomes (Graph 3.4.3 a).

Countries with growth of house price index, deflated (1 year % change) above 6% in 2022 in blue																										
BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE

At country level, the following developments are worth highlighting:

- House prices are significantly overvalued and have been falling recently in **Czechia**, **Luxembourg**, the **Netherlands**, and **Sweden**. In **Denmark**, **Germany** and **Slovakia**, prices are also falling but overvaluation is less significant and has almost been completely corrected in Denmark. Over the last decade, these countries have seen steep increases in prices, particularly relative to income, including over the pandemic. Luxembourg, and especially Czechia also displayed very high growth in 2022. In Slovakia, a strong acceleration in growth took place in most of 2022. In Sweden, Denmark, Germany and Luxembourg, the increases in interest rates are greatly reducing the borrowing capacity of households to below 2019 levels, while in the Netherlands and Czechia the increase in interest rates are not estimated to offset the positive impact of income growth over the last few years. In Sweden, the impact on the construction sector and on household consumption is already visible and being reflected in the total economy. The evolution of the housing market poses risks for the overall economy in these countries.

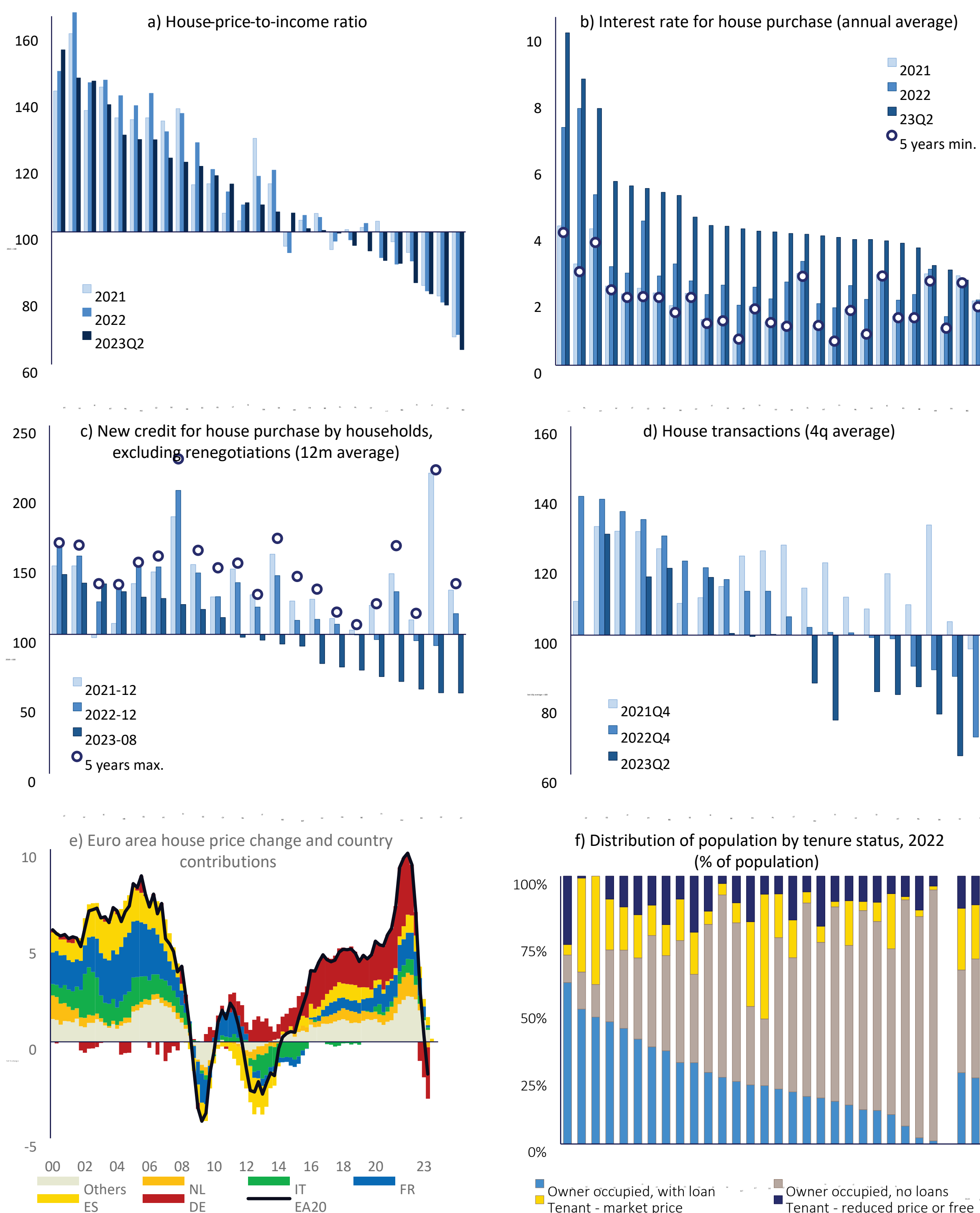
- House prices are overvalued and still increasing in **Bulgaria**, **Spain**, **Latvia**, **Portugal**, and **Slovenia**. In these countries the evolution of house prices can be seen as a risk factor for a future sharper correction if economic conditions were to deteriorate, with house prices being strongly overvalued in Portugal. In **Belgium** and **Hungary** overvalued house prices have fallen slightly in the most recent period, although in both cases the annual rate of growth remains positive. **France**'s overvalued house prices have shown several quarters of shallow reductions. In **Austria**, some small recent reduction appears to have stalled in the most recent data, with house prices remaining strongly overvalued.

- In **Greece**, **Croatia** and **Lithuania**, house prices are not estimated to be overvalued but increased at a strong pace, despite the change in economic conditions. Affordability concerns also increased, in particular in Greece and Croatia.

- In **Finland**, prices are estimated to be slightly undervalued and are falling fast, as the level of household debt relative to income is very high, and the increase in interest rates is having a significant impact on household demand for housing. In **Ireland**, house prices have been increasing significantly faster than income since 2013, and the ratio of household debt to

income is high. House prices, measured in years of income needed to buy a typical home, are very high and have not yet started to adjust.

Graph 3.4.3: **Selected graphs on the housing market**

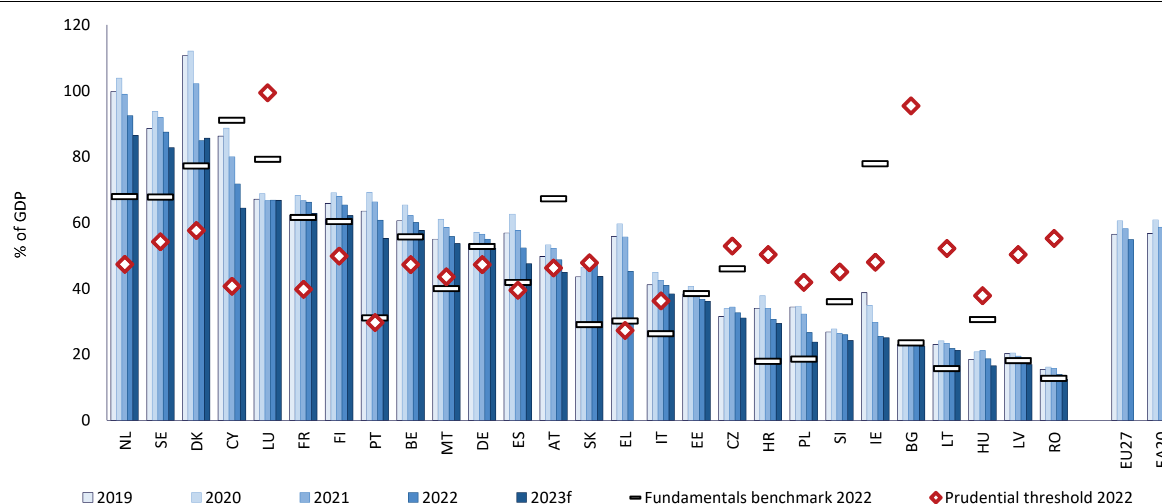


(1) Graphs a, b and c, countries are ordered by decreasing order of the last data. (2) In Graph d, countries are ordered by decreasing order of 2022Q4 values, as 2023 data are not available or missing for several countries. (3) In Graph e, the euro area house price before 2005 is estimated. (4) In Graph f, countries are ordered by decreasing order of share of owner occupied with loan.
Source: Eurostat, European Commission, ECB, AMECO

3.5. HOUSEHOLD DEBT AND SAVING

Household debt ratios continued to decrease in 2022 and came in close to or below their pre-pandemic level in most EU countries (Graph 3.5.1). After a long period of decline, household debt-to-GDP ratios spiked in 2020 and then fell again to 56% in the euro area and 55% in the EU by 2022, just below their pre-pandemic level. The debt-to-gross household disposable income ratios evolved in a similar way, declining in 2022 to 94% in the euro area and 92% in the EU on the back of strong nominal income growth. Most EU countries, including those with the highest levels of debt, have seen their household debt-to-GDP ratios fall below their 2019 levels. At the same time, in almost half of the Member States, household debt remains above the thresholds suggested by economic fundamentals and by prudential concerns ([50]). The decline in the household debt-to-GDP ratios in 2022 was strongly driven by denominator effects, as strong nominal GDP growth, reflecting extraordinary inflation and (in many countries) significant real GDP growth, offset the Impact of still strong credit flows (Graph 3.5.3 a). Passive deleveraging was particularly strong in the countries with the highest debt ratios, contributing to EU/euro area convergence.

Graph 3.5.1: **Household debt-to-GDP ratios**



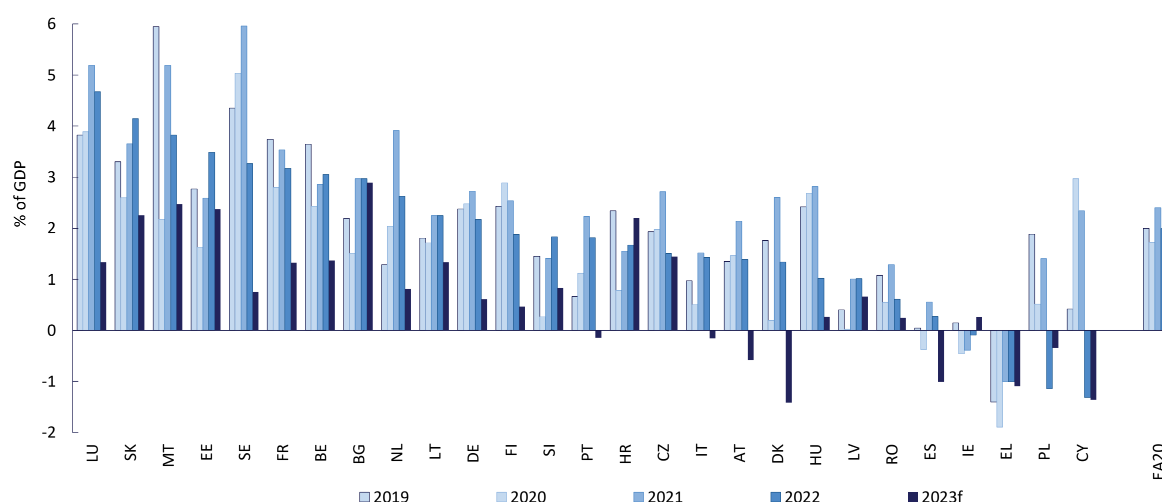
(1) Debt comprises loans (F4) and debt securities (F3), consolidated. 2023 figures present projections based on available in-year data and forecasts.
Source: Eurostat, AMECO, ECB and European Commission

As of mid-2022, tightening financing conditions are reducing net credit flows, but pose challenges for existing borrowers. After a long period of growth, net credit flows peaked between mid-2021 and mid-2022, and then plunged as a result of soaring interest rates (Graph 3.5.4 a) and declining residential property transactions in many countries (see Sections 3.4 and 3.6 for more details). Countries with a larger increase in the cost of borrowing saw, on average, a greater contraction in credit flows. In most Member States, net credit flows nevertheless remained positive in 2022 as a whole (Graph 3.5.2). While the reduction in credit flows may ease the overall risk associated with further household debt accumulation, the increase in financing costs presents

([50]) For definitions and methodologies, see footnote 32.

a risk to existing debt holders, in particular in a context of already high pressure on purchasing power. High financing costs can also have a negative impact on asset valuations.

Graph 3.5.2: **Net credit flows to households**



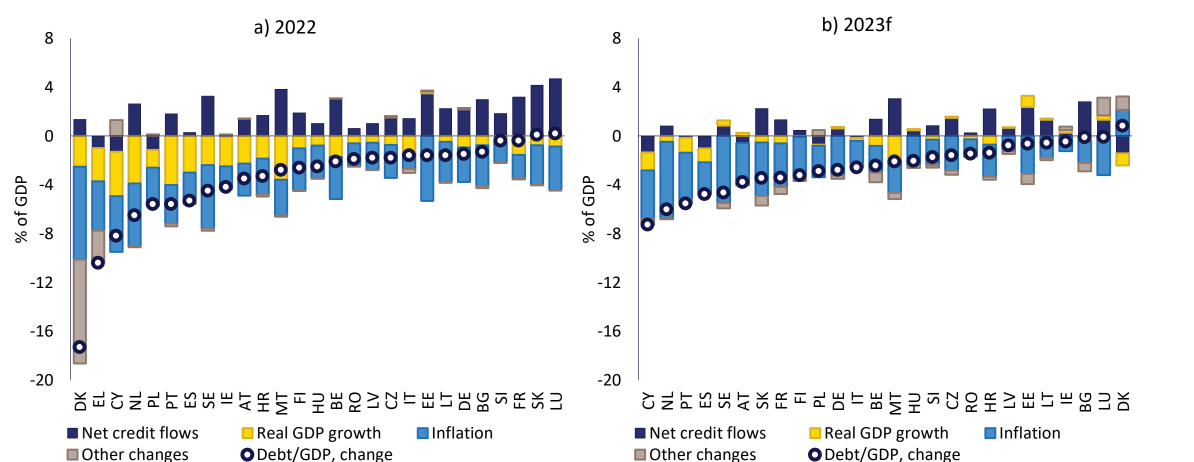
(1) Credit flows reflect adjusted loans (net flows) as reported by the ECB. 2023 figures present projections based on available in-year data and forecasts
Source: Eurostat, AMECO, ECB and European Commission

Some debtor households' balance sheets are significantly affected by the recent strong increase in interest rates, and there are risks in the near future. Across the EU, households' cost of borrowing soared as of 2022. By mid-2023, the euro area average cost of borrowing for new (purely new and renegotiated) loans had tripled vis-à-vis its mid-2021 level. In recent years, loans with fixed interest rates have won ground over those with flexible interest rates in several Member States, meaning that many households may remain well protected against the interest rate increases in the short to medium-term (Graph 3.5.4 d). Still, in some countries, banks provide almost exclusively loans with variable interest rates. Moreover, in some countries, in spite of a recent shift towards more stable rates, variable interest rates still prevail among the stock of existing loans. Finally, in some countries the proportion of variable interest rates has recently picked up again in response to the changing financing conditions. This means that certain pockets of households may be exposed to abrupt rises in expenditures in the face of interest rate shocks. Box 3.5.1 contains more details.

Subdued borrowing and inflation are continuing to exert downward pressure on household debt-to-GDP ratios in 2023. In Q2-2023, the euro area (EU) household debt-to-GDP ratio dropped to 55% (53%), its lowest level since 2005 ([51]). Measured as a share of gross disposable income, it fell to 90% (89%) in the same quarter, also markedly below its pre-pandemic level. If trends observed over the first half of 2023 persist, all but two EU Member States will see a reduction in household debt-to-GDP ratios in 2023. In almost all EU countries with high or very high household debt, deleveraging is expected to be extensive, reaching several percentage points (Graph 3.5.3 b). The most recent data suggest that in more than half of all Member States, net credit flows have (almost) stalled in the first half of 2023, or even turned negative, with a higher loan volume being repaid than issued, in response to tightening financing conditions. In the countries with the highest debt levels, flows dropped considerably as well.

([51]) Source: Commission calculations based on ECB-QSA and ESTAT data.

Graph 3.5.3: **Contributions to changes in household debt-to-GDP ratios**



Source: Commission calculations based on AMECO, Eurostat, ECB data

Household savings have come down since 2020 but remain mostly above their pre-pandemic levels. Gross savings (as a % of disposable income) had gone up significantly during the COVID-19 pandemic, but came down over 2021 and 2022 to more usual levels, where they plateaued just above their pre-pandemic level (Graph 3.5.4 b). At the same time, important differences can be observed between countries. Overall, gross savings seem to be holding up more strongly in countries with an already higher savings rate to begin with. In many countries which started out with lower savings rates before the pandemic, gross savings have recently been decreasing, possibly as a result of the higher impact of increases in the cost of living in these countries as a result of high inflation. These differential dynamics risk contributing to divergence in the euro area.

The outlook for savings developments is moderately positive, with real incomes expected to stay stable in 2023 and start growing again in 2024, as inflation gradually subsides. In spite of buoyant nominal wage growth, real income and purchasing power growth have lagged behind as a result of high inflation. Real gross disposable income per capita contracted in 2022. Real compensation per employee is expected to recover to 2019 levels only by 2024 ([52]). While less than half of the EU countries had recovered to 2019 levels of real compensation by 2022, by 2024, all but six are expected to have recovered to those levels. Employment dynamics have so far been supportive of growth in disposable incomes, even if they are expected to slow down in the future. Unemployment, already at historical lows, is forecasted to remain stable in 2023 and return to its downward trend in 2024, boding well for the outlook on income growth. These positive effects should have a positive impact on household savings and support households' abilities to meet their debt obligations overall.

In general, the household sector has over time increased its ability to withstand housing market shocks. House price corrections risk reflecting adversely on some households' balance sheets. But households' vulnerability to house price shocks seems to have improved over time, as loan-to-value ratios have generally decreased, in particular at the higher end of their distribution. While in 2014, the 90th percentile of the loan-to-value ratio for the main residence stood at 100% for the euro area, this has come down to 87% by 2021 ([53]). In parallel, the 90th percentile of the

([52]) Calculated using the private consumption deflator.

([53]) This means that in 2014, the 10% of households with the highest loan-to-value ratio for their main residence's mortgage, all had a loan-to-value ratio of more than 100%, in other words, the value of the mortgage exceeded the value of the property concerned.

debt-to-assets ratio of indebted households has come down from 128% to 97% ([54]). A similar trend can be observed for most individual countries, in particular those with very high loan-to-value and debt-to-assets ratios to begin with in 2014. At the same time, stricter macroprudential regulations may have come at the cost of reducing access to the housing market for some households.

Box 3.5.1: The impact of increased interest payments on households

Interest paid by households in the euro area has been increasing since mid-2022, but NPLs have continued to decline. Between Q2-2021 and Q2-2023, the share of household gross disposable income spent on interest payments has grown from 0.8 to 3%. At the same time, interests received by households also increased significantly, overcompensating the increase in interests paid in almost all countries for which data are available, with the notable exception of the countries with the highest household debts (the Netherlands, Sweden and Denmark). However, the gains from rising interest rates may accrue to different households than the losses and therefore provide limited cushioning. Despite this, the proportion of NPLs to households continued to decline in 2022, with minor upticks in just a few Member States in the first half of 2023 (Graph 3.5.4 f). This followed a strong improvement in 2021 in the highest risk countries thanks to dedicated policy measures. Risks remain on the downside however, with some signs of the Stage 2 allocation for mortgages picking up recently (see Section 3.6) ([55]).

For low-income households who hold mortgages, the rising interest burden may bite strongly and exacerbate hardship resulting from already high inflation. The rising interest burden is more likely to fall onto richer households: they are less likely to be credit-constrained and more likely to take out a mortgage. Moreover, they tend to take out larger loan volumes ([56]). For the relatively few households in the bottom income quintile which take out a mortgage, the debt service-to-income ratio tends to be higher, however (Graph 3.5.3 e): their median monthly debt payment covers 21% of gross monthly income on average in the euro area, as compared to 13% for mortgage holders overall. Median debt service payments for the bottom income quintile even exceed 40% of monthly income in Cyprus, Portugal, Greece and the Netherlands (Household Finance and Consumption Survey, 2021). Debt-holding households in the bottom quintile make up around 2.5-10% of the population in those countries.

([54]) Source: HFCS 2014 and 2021 waves.

([55]) Stage 2 loans are loans categorised as underperforming (see also Section 6 for more details). Source: Risk Dashboard, Data as of Q1 2023, European Banking Authority.

([56]) See 2021 ECB-HFCS data

Countries with household debt to GDP ratios above fundamental and prudential thresholds in 2022 in blue																										
BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE

At country level, the following developments are worth highlighting:

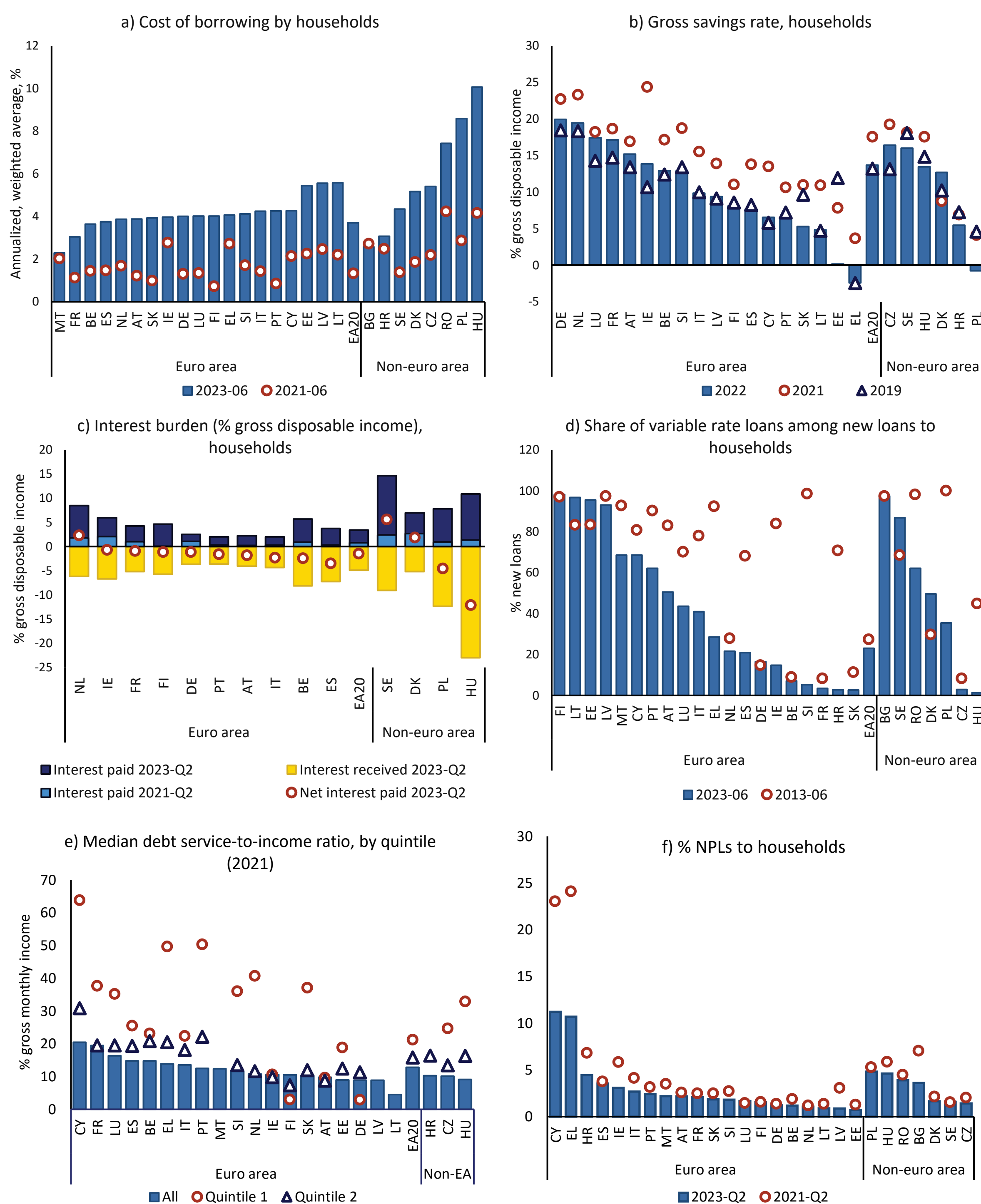
- The **Netherlands**, **Sweden**, **Denmark** and **Cyprus** have very high household debt (above 70% of GDP in 2022), although debt levels have been falling in recent years. While the Netherlands, Denmark and Cyprus have already undergone a decade of deleveraging, the debt ratio was increasing over time before the pandemic in Sweden, and there is a risk this trend will pick up again shortly in the absence of policy changes. In the cases of Denmark, the Netherlands and Sweden, household debt is particularly high when measured as a share of gross disposable income. Lately, net interest payments have also increased substantialy in these countries. Risks to the household sector are compounded by the high share of variable interest rates for Sweden, Denmark, and Cyprus; and the high median debt service to income ratio for Cyprus overall, and for debt holders at the bottom of the income distribution in Cyprus and the Netherlands, and the low savings rate and high proportion of non-performing loans to households in Cyprus.

- **Luxembourg**, **France**, **Finland**, **Belgium** and **Slovakia** have moderate to high household debt stocks (between 35 and 70% of GDP in 2022) that have observed a longer-term upward trend over the last decade, strongly outstripping the post-2020 decline. When expressed as a proportion of household gross disposable income, Luxembourg is among the countries with the highest household debt in the EU. Risks to the household sector are exacerbated by the high share of variable interest rates in Finland and Luxembourg, the high median debt service-to-income ratio for France and Luxembourg overall as well as for debt holders in the bottom quintile of the income distribution in Luxembourg, and by the low savings rate in Slovakia For the case of France and Slovakia, these risks are mitigated by the fact that the vast majority of mortgages at fixed rates.

- **Portugal**, **Germany**, **Spain**, **Malta**, **Austria**, **Greece**, **Italy** and **Estonia** also have moderate to high household debt levels, but these have declined over the last decade, in some cases very substantially. Debt stocks nevertheless continue to exceed their fundamentals-based threshold by more than 10 percentage points in Spain, Malta, Greece, and Italy. Risks to the household sector are compounded by the high share of variable rate loans in Estonia, Malta, Portugal, Austria, and Italy, the low savings rate in Greece, Estonia, and Portugal, and the still high proportion of non-performing loans in Greece and, to a lower extent, in Spain, despite the declines that have taken place in recent years.

- The relatively high proportion of non-performing loans to households may also still be of concern for **Hungary, Croatia, Poland, Bulgaria, Romania** and **Ireland**, in spite of their relatively low household debt-to-GDP ratios (below 35%). For Ireland, household debt is still relatively high (around the euro area/EU average) when expressed as a proportion of household gross disposable income.

Graph 3.5.4: **Selected graphs on household savings and debt**



Panel (a): Cost of borrowing concerns new (+renegotiated) loans for house purchase by HH and NPISH. Source: ECB-MIR. (b): The gross savings rate is measured as a proportion of HH (+NPISH) gross disposable income, adj. for change in net equity in pension funds reserves. Source: AMECO. (c): Net interest paid = interest paid - received. Source: ECB-QSA (D41). (d): Variable rate loans are defined as loans with < 1 year fixation period. No data for MT, DK. If 2023-06 data are missing, 2023-05 or 2023-03 data are shown. If 2013-06 data are missing, data for 2013-05 or 2013-07 data are shown. Source: ECB-RAI. (e): Data reflect the ratio of total monthly debt payments to gross monthly income for HH with debt payments in the bottom two quintiles of the income distribution and for all HH. Debt service-to-income ratios are usually lower for quintiles higher up. Source: ECB-HFCS (2021). (f): NPLs are defined as HH' gross non-performing loans and advances, % of total gross loans and advances. Source: ECB-CBD2.

Source: AMECO, Eurostat, ECB, Commission

3.6. FINANCIAL SECTOR

The EU banking sector performed well in 2022, benefiting overall from the increase in interest rates. Over 2022, the financial system was marked by the effect of rising interest rates and elevated inflation, which led to pressure on asset valuation, including real estate. The return on equity showed a significant increase in 2022, especially for large banks; most banks had a higher pass-through of the monetary policy tightening to lending rates than to deposit rates, raising their net interest margins and delivering higher net interest income. The Common Equity Tier 1 (CET1) ratio of EU banks experienced a slight decline in 2022 due to strong lending activity in the first half of 2022, but it still remained close to record heights (Graph 3.6.1 a and Graph 3.6.3 a). The EU banks maintained a robust liquidity position, primarily driven by a large share of high-quality liquid assets. Throughout 2022, non-performing loans (NPLs) remained relatively stable and low (Graph 3.6.1 b), despite the further withdrawal of moratoria on loan repayments introduced after the COVID-19 pandemic outbreak.

Since mid-2022, there has been a significant tightening of financial conditions, impacting credit provision to the rest of the economy. The credit growth remained strong in the first half of 2022 despite increasing lending rates for households and non-financial corporations (NFCs) in the euro area and already high interest rates in several non-euro area countries (Graph 3.6.3 c and Graph 3.6.3 d) Over the second half of 2022, credit conditions tightened significantly both for NFCs and households amid ongoing monetary tightening, especially in the euro area. Credit provision to NFCs and households (see also Sections 3.3 and 3.5) slowed down noticeably (Graph 3.6.3 e) ([57]). According to the Bank Lending Survey of the euro area, lending standards for both households and businesses continued to be tightened in the first half of 2023, particularly in the first quarter. This tightening was driven by higher risk perception and lower risk tolerance. In 2023, there was a notable decline in demand for loans from both households and firms amid high interest rates. These trends are expected to persist in the rest of 2023 ([58]).

The resilience of the EU banking sector has continued into 2023. Despite several episodes of heightened turmoil at global level, the EU banking sector is showing resilience ([59]). NPLs have remained broadly stable despite the pressures on the loan repayment capacity of households and corporates amid higher interest rates and lower disposable income. The NPL ratio (for the median large EU bank) ([60]) remained stable at 1.8% at the end of the first quarter of 2023 ([61]). In parallel, the share of loans categorised as having registered an increase in credit risk (Stage 2 loans) marginally declined but remained relatively high at 9.3% in the euro area in the first quarter of

([57]) ECB Financial Stability Review, May 2023, EBA Risk Dashboard, Q4-2022, April 2023.

([58]) ECB Euro area Bank Lending Survey, First quarter of 2023, Second quarter of 2023, Third quarter of 2023.

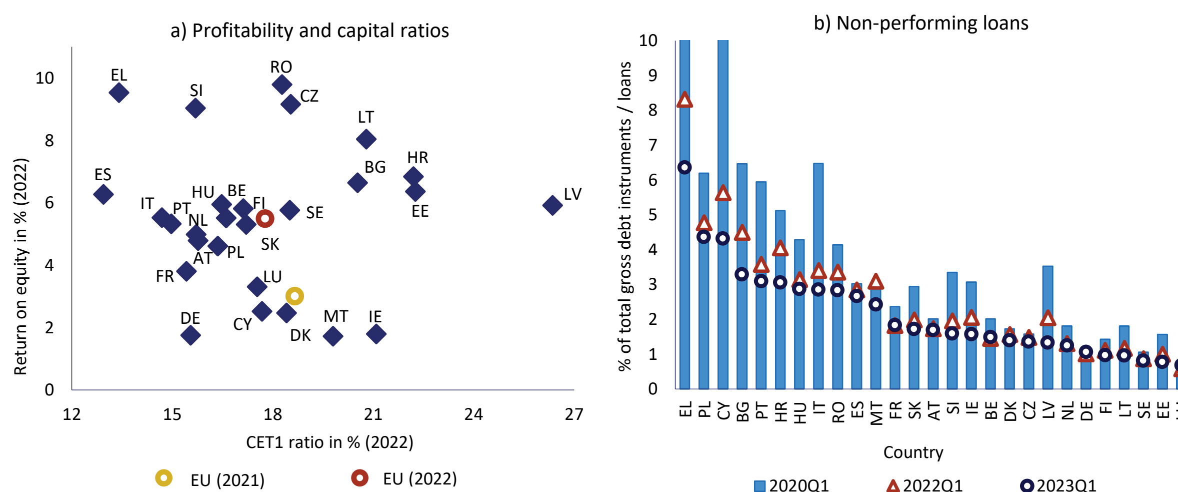
([59]) EU banks' resilience was further boosted by robust capital and liquidity requirements, significant NPL workout efforts in the aftermath of the 2008 global financial crisis, borrower support measures granted after the onset of the COVID-19 pandemic, as well as a stringent regulatory and strong and effective supervisory oversight, as recently further underscored with an agreement on the Banking Package.

([60]) Large banks data refer to those banks whose data are collected by European Banking Authority (EBA) for EU-wide stress tests and transparency exercises.

([61]) EBA Key Risk Indicators. This is driven both by lower numerator (ongoing NPL decline) and higher denominator (growth of total stock of loans).

2023 ([62]). Capital ratios have recovered after a slight decrease in 2022, which was driven by an increase in risk-weighted assets amid strong lending growth. The aggregate CET1 ratio for large banks stood at 16.5% by the second quarter of 2023 ([63]). The retun on equity has shown a strong increase, rising from 7.5% in the final quarter of 2022 to nearly 12% in the second quarter of 2023 (for the median large EU bank), supported by strong net interest income. The valuations of EU banks, which had been recovering since mid-2022, experienced a notable decline in March 2023 following the failure of three US mid-to-small-sized banks and the failure of the G-SIB Credit Suisse and the subsequent government-assisted purchase by UBS, despite limited direct exposure to them. However, bank stock prices recovered subsequently.

Graph 3.6.1: **Banks: profitability, capital ratios and non-performing loans**



(1) The Common Equity Tier 1 (CET1) ratio encompasses ordinary shares and retained earnings. CET1 ratio and return on equity are average of quarterly data over the year 2022. The average value for the EU is unweighted by the economy size. The NPL ratio in 2020Q1 in EL was 34% and in CY 18%.
Source: ECB Consolidated Banking Data, European Commission

In the future, the more difficult and uncertain economic conditions may adversely affect the asset quality and the profitability of the banking sector. So far, banks, in particular those with a high balance sheet sensitivity to interest rate movements, have benefited from higher interest rates, increasing their net interest income. However, the full impact of higher interest rate on the banking sector depends on the evolution, assets and deposits repricing, loan volume developments, and the banks' funding mix. Funding costs for banks in the euro area are expected to rise due to the need to refinance maturing parts of the Targeted Longer-Term Refinancing Operations ([64]). The flat yield curve entails challenges for the maturity transformation function of banks and, as a result, banking profitability. Weaker economic growth, higher interest rates and persistent inflation may put pressure on firms' profitability and household incomes, resulting in reduced banks' asset quality ([65]). Bank exposures to the manufacturing and real estate sectors appear to be particularly problematic, given their relatively high share of vulnerable loans and the EU banks' significant exposure to these sectors.

([62]) ECB Supervisory Banking Data. Under IFRS 9, applicable entities must now place financial instruments into three distinct stages, including 'performing' (Stage 1), 'underperforming' (Stage 2) and 'non-performing' (Stage 3). Stage 2 refers to loans with significant increase of credit risk since initial recognition.

([63]) EBA Risk Dashboard, Q4 2023.

([64]) ECB Financial Stability Review, May 2023.

([65]) Corporate vulnerabilities and the risks of lower growth and higher rates, box in ECB Financial Stability Review, May 2023.

The 2023 stress tests conducted by the European Banking Authority (EBA) and the ECB have confirmed the resilience of the EU banking sector. In July 2023, EBA and ECB published results of their EU-wide and euro area bank stress tests respectively ([66]). The results of the stress tests reveal that European banks remain resilient even under the adverse scenario, which includes a severe EU and global recession, increasing interest rates and higher credit spreads. The banks' current solid capital position allows them to withstand the capital depletion that occurs under the adverse scenario ([67]). The estimated adverse impact on capital is lower than in the previous stress test round in 2021. The EBA test indicates a heterogeneous impact of scenarios across different economic sectors ([68]). The ECB test, on the other hand, highlights that smaller banks would experience higher capital depletion than the larger ECB-supervised banks. However, even after the stress scenario, their capital ratio remains higher than their larger counterparts due to their stronger starting capital position. On the positive side, the undertaken reforms should make it easier for banks to contain any potential accumulation of NPLs and to continue to support the EU's economy by extending loans to households and companies even in times of an economic slowdown.

The non-bank financial sector is challenged by risks related to asset price correction and represents a risk through its interconnections with the banking system. High interconnectedness between European banking and non-banking sector represents another risk in the future with funding from non-bank being the main spillover channel as non-bank financial intermediaries hold their liquid assets as bank deposits and short-term securities ([69]). The investment fund sector has significantly increased in the EU over the last decade and is concentrated in a few countries (Graph 3.6.3 b). Since mid-2022, however the sector has experienced significant capital outflows and the funds started to decrease their exposure to lower rated corporates in favour of investment grade sovereigns ([70]). Investment funds, insurance companies and pension funds remain exposed to risks of asset price corrections, including real estate, whose share in portfolios has increased in the recent years. While the solvency of insurance companies remained high in 2022, profitability decreased due to losses on interest rate sensitive instruments. However, the long-term impact of increased interest rates is expected to be positive due to higher returns on new investment. Life insurance and pension funds face potential lower demand in face of declining real income of households. Non-life insurance, in turn, may face higher costs of future claims amid persistent inflation. The insurance sector is challenged by elevated

([66]) These stress tests assess the ability of European banks to withstand adverse economic conditions over a three-year period, considering both a baseline and an adverse scenario. The EBA EU-wide stress test involved 70 banks from 16 EU and EEA countries (20 more than in the previous stress test round), covering 75% of the EU banking sector assets; the ECB stress tested 98 banks under its direct supervision. Of those, 57 are the euro area's largest banks which are included in the EU-wide stress test coordinated by the EBA, and 41 are medium-sized banks outside the EBA sample. Together they represent 80% of the total banking sector assets in the euro area.

([67]) Under the baseline scenario, the capital Tier 1 ratio is expected to increase by 136 bps to reach 16.3% in 2025. The capital depletion under the adverse stress test scenario is measured at 459 basis points (bps) in the EBA test and 480 bps in the ECB test. As a result, the fully loaded CET1 ratio at the end of the scenario is projected to be 10.4% for both tests in 2025, which is sufficient for banks to continue supporting the economy even in times of severe stress.

([68]) Losses on large corporates and SMEs account over half of total credit losses. The manufacturing sector accounts for around a fifth of the losses on corporates – with loss rates for energy intensive companies being notably higher. Exposures to companies operating in the accommodation and food services and the construction sectors experience the highest loss rates and are thus the most affected by the scenario.

([69]) Key linkages between banks and the non-bank financial sector, Special feature B in ECB Financial Stability Review, May 2023.

([70]) ECB Financial Stability Review, May 2023. In January 2023, the EBA launched the 2023 EU-wide stress test and released the macroeconomic scenarios (adverse scenario heightened geopolitical tension with high inflation and higher interest rates), results to be published by end of July 2023.

uncertainty and new climate, cyber and geopolitical risks, which may be difficult to quantify and risk negatively affecting the insurability of certain risks in the future ([71]).

Financing conditions for private sector and governments are differentiated across the EU, and even within the euro area. The tightening of funding conditions is particularly strong among some non-euro area Member States. Within the euro area, there is also increasing divergence in funding conditions for private sector. Some divergence has been a long-standing phenomenon, but most recently varying pass-through of policy rates to lending rates contributed, especially for households. This discrepancy can be attributed, at least in part, to differences in the share of variable rates in loan portfolios. Additionally, the maturing of Targeted Longer-term Refinancing Operations could lead to further differentiation in funding conditions among banks, and in turn lending rates for households and non-financial corporation. The divergence in financing conditions is also evident in the case of sovereign funding costs. Banking sectors that have a strong domestic bias may be more vulnerable to changes in their home country's fiscal and economic conditions. Furthermore, since the COVID-19 pandemic, there has been a significant increase in sovereign exposure to the corporate sector in some countries via among other things contingent liabilities (see also Section 3.7). This creates a risk of a doom loop, where adverse developments in one sector (e.g. corporate sector) can impact and potentially lead to problems in other sectors (e.g. sovereign and banking sector).

Box 3.6.1 – Financial sector and real estate

The exposure of the European financial sector to real estate has increased over the last decade. Besides standard mortgage lending by the banking sector that represents a significant part of their portfolios, other forms of exposures to real estate by banks but also by non-banks, including real estate investment trusts, have gained prominence in the past decade. While mortgage lending remains one of the main activities of EU banks, the relevance of mortgages for banking balance sheets and mortgages arrangements vary significantly across Member States. Graph 3.6.3 shows the share of total bank assets that correspond to mortgages for households and non-financial corporations, to give an insight into the exposure of the banking sector to real estate ([72]). Most of the mortgages are granted to households and are therefore mainly used to buy houses. In 2022, several Member States received warnings (Bulgaria, Croatia, Hungary, and Slovakia) and recommendations (Austria, Germany) from the European Systemic Risk Boad regarding mid-term vulnerabilities stemming from their residential real estate sectors. The mortgages granted to corporations are commonly collateralised by commercial real estate and represent a comparatively small part of banking portfolio, although exposures are very significant in some Member States. The volatility of real estate prices represents a potential risk for financial sectors in terms of repricing of mortgage collateral but also of prices of other assets linked to real estate markets such as mortgage-backed securities or real estate-related funds.

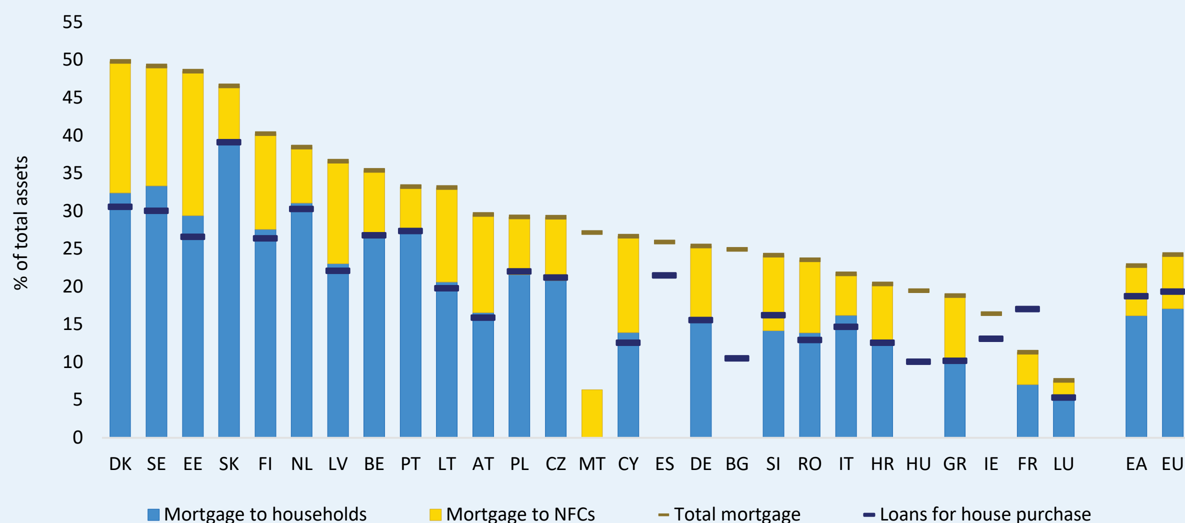
Real estate markets are experiencing a correction overall, and the commercial real estate (CRE) is subject to the most acute risks. While both residential and CRE prices followed a similar upward trend until the COVID-19 pandemic, there has been a notable decoupling since then. The increase in interest rates has negatively impacted the borrowing capacity of households and their ability to service existing debts, including mortgages (see also sections 3.4 and 3.5). Combined with an overvaluation of residential real estate in many EU countries, this has led to turns in housing markets since mid-2022, with nominal prices decreasing in some Member States, and a slowdown of their growth rates in several others. The CRE market has already faced

([71]) EIOPA Financial Stability Report, June 2023.

([72]) The comparison across countries is subject to some caveats. For example, mortgages for households in some countries are not fully collateralised by house purchases as a form of tax and notary fee optimisation.

significant challenges since 2020 (see also Section 3.3). CRE prices and transactions already experienced substantial declines in 2020 and 2021, with non-prime properties being particularly affected. Although the CRE market seemed to have stabilised in the first half of 2022, the downturn resumed again from mid-2022, impacting offices, in particular ([73]).

Graph 3.6.2: **Mortgages and bank loans for house purchase, 2022**



(1)
Source: ECB

The CRE sector is strongly interconnected with both banks and non-banks but there are notable differences across countries. The decline in CRE prices has put pressure on indebted firms and financial institutions that have exposures to real estate. Banks and non-banking financial institutions across the EU have varying degrees of exposure to CRE and are geographically clustered. Real estate investment funds play a significant role in holding CRE in some countries and their relevance has increased in the EU over the last decade ([74]). The two-sided impact between investment funds, exposed to liquidity risks, and CRE, subject to valuation uncertainty, poses a new vulnerability in the European financial market ([75]). However, EU banks also have direct (via lending or investment) and indirect (via Real Estate Investment Trusts) exposures to residential and commercial properties ([76]). The complex cross-border linkages and data gaps, especially in the investment funds sector, make country-level risk assessment challenging. Based on available data, it seems that Member States such as Sweden, Germany, Luxembourg, and the Netherlands have the highest financial sector exposure to CRE ([77]). In January 2023, the European Systemic Risk Board issued a recommendation on vulnerabilities in the CRE sector in the European Economic Area,

([73]) ECB Financial Stability Review, May 2022, May 2023.

([74]) Most real estate funds are open-ended, thus large request of redemption can cause fire sales of their CREs assets. Those funds are mainly located in Germany, France, the Netherlands, Italy and Luxembourg. EBA, Transparency exercise, June 2022.

([75]) The growing role of investment funds in euro area real estate markets: risks and policy considerations, ECB Macroprudential Bulletin, April 2023.

([76]) ESRB (2023): Vulnerabilities in the EEA commercial real estate sector, January 2023.

([77]) CRE accounts for more than 9% of euro area bank risk exposure. In the euro area, of the 12.6% non-financial corporations loans growth between Q4-2019 and Q2-2022, almost half (5.6 percentage points) was dedicated to real estate and professional services.

which encompass both cyclical and structural factorsIt urged authorities to improve the monitoring of systemic risks arising from the CRE sector and promote sound financing practices (78).

Countries with total financial sector liabilities, non-consolidated (1 year % change) above 16.5% in 2022 in blue																										
BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE

At country level, the following developments are worth highlighting:

- Despite significant progress in recent years, financial systems in **Cyprus** and **Greece** are still vulnerable. While the NPL ratio of the banking sector has been strongly reduced in previous years, non-performing debt remains in the economy through credit servicing companies and its workout continues to face challenges. Moreover, the NPL ratio of the banking sector is still above the EU average. The Stage 2 loans ratio and forbearance of the Greek banking sector is also high compared to the EU average. The banking sector capitalisation in Cyprus is close to the EU average, but in Greece falls below it. Profitability increased well above the EU average in 2022 in Greece, in Cyprus it remained below the EU average in 2022 but significantly increased in the first half of 2023.

- Banks in **Italy** and **Portugal** have significantly decreased their NPLs and their capitalisation remains sufficient, but below the EU average (Portuguese banks recorded a strong increase in the capital ratio in the first half of 2023). While Portuguese banks are exposed to residential real estate, Italian banks have a non-negligible exposure to commercial real estate, but the vulnerability of Italian banks stemming from these exposures has remained low so far. Strong exposure to the domestic sovereign remains a risk for banks in both countries.

- The banking sector in **Germany** and **France** features relatively low profitability and capitalisation. Recent stress tests revealed potential vulnerabilities of several financial institutions from these countries. Both banking systems, particularly in Germany, have large exposures to both residential and commercial real estate, which is subject to correction. This is also the case for **Spain** where capitalisation is low, but profitability is higher.

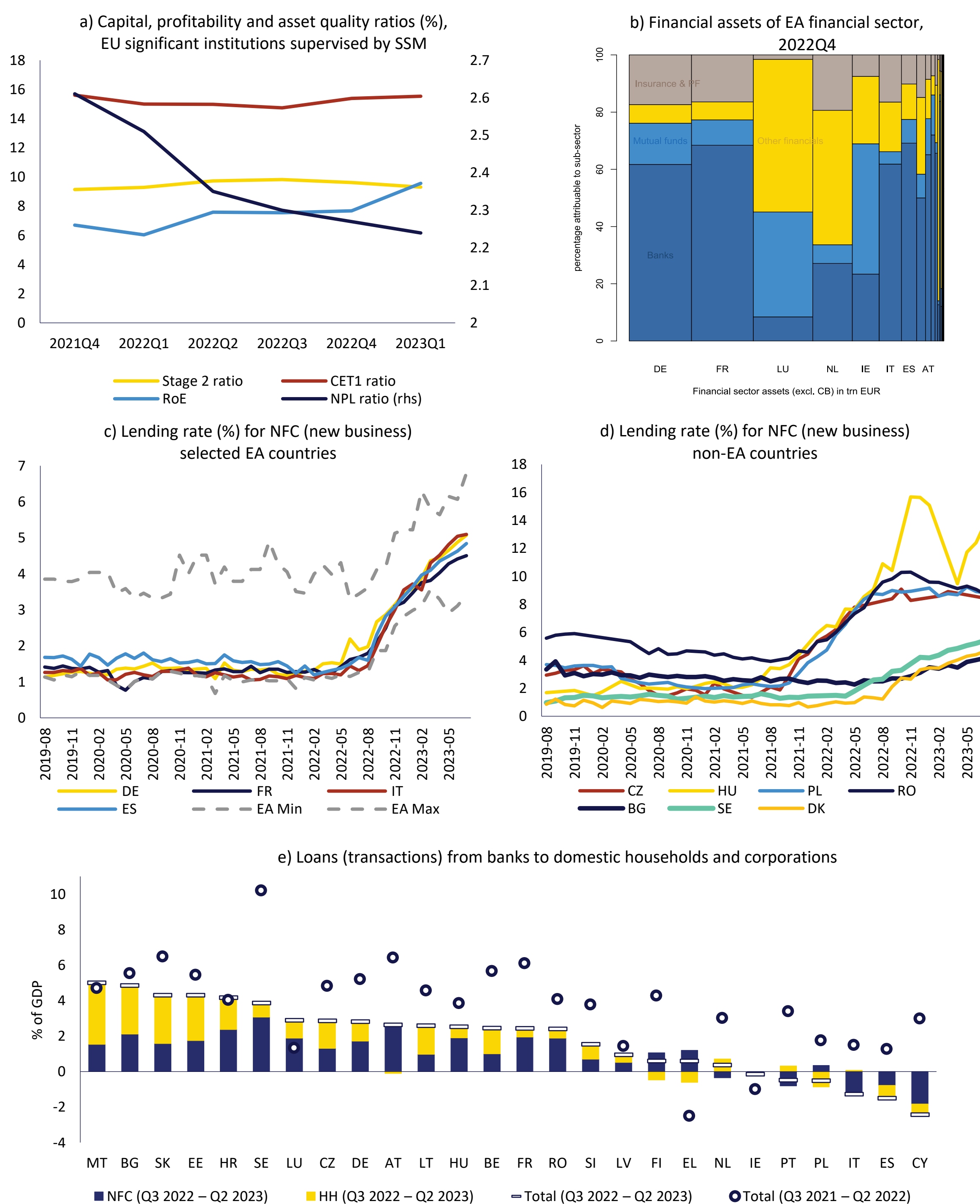
- Relatively high exposures of banks to real estate can be found in **Luxembourg** and **the Netherlands,** where banks are well capitalised. Vulnerabilities related to the non-banking financial sector are sizeable in view of the general adjustment of asset prices. This is particularly the case in Luxembourg with a very large investment funds sector that also features large cross-border exposures.

- Banks in **Sweden**, **Denmark** and **Finland** have strong exposure to both residential and commercial real estate, which is undergoing a significant correction, most notably in Sweden, where interest rate tightening is also most pronounced. This increases banks' net interest rate income amid the large share of floating rate mortgages but sets risks for the borrowing and repayment capacity of households. However, in general banks are well capitalised. Significant exposure to real estate can also be found in **Estonia** and **Slovakia**.

- **Bulgaria**, **Poland** and **Hungary** still feature relatively high NPL ratios and Stage 2 loans, but the banks in these countries are well capitalised and profitable, notably in Bulgaria where credit growth remains rather dynamic.

(78) ESRB/2022/9.

Graph 3.6.3: **Selected graphs on the financial sector**



Source: ECB, European Commission

3.7. GOVERNMENT SECTOR

Government debt ratios decreased in most Member States in 2022, supported by strong nominal GDP growth, but generally remain above pre-pandemic levels. In 2022, the debt-to-GDP ratio decreased in almost all EU countries, with the EU and euro area aggregates declining by nearly four percentage points to reach 84.8% and 92.5% respectively (Graph 3.7.1 a). This decrease is mostly driven by the recovery of nominal GDP after the pandemic (see Graph 3.7.2 d). Despite the reduction, the debt-to-GDP ratio remained above the pre-pandemic levels in most Member States. Fiscal deficits narrowed in 2022 in almost all EU countries, despite sizeable support packages for households and firms related to high energy prices (accounting for 3.6% of GDP for the EU as a whole), in part due to the removal of pandemic support measures (Graph 3.7.1 b). Deficits were below 3% of GDP in over half of the Member States, while the average deficit was 3.6% of GDP and 3.3% of GDP for the euro area and for the EU as a whole respectively.

The government debt-to-GDP ratio is expected to decrease further in most of the EU countries in 2023, with small changes in 2024. In most Member States, government debt is forecast to fall in 2023 but still to remain higher than its 2019 levels, in some cases by nearly 15 percentage points (Graph 3.7.1 a). The improvement is a result of continued nominal economic growth, driven by inflation. The declines in the debt ratio should continue to be more sizeable in the most indebted countries as economic growth has a stronger deleveraging effect when debt-to-GDP ratios are larger. In some countries with low or moderate government debt ratios, these are expected to stabilise or slightly increase**.** In-2024, reductions of debt ratios are forecast to be smaller despite government deficits being expected to improve in all Member States, as the passive deleveraging effect is set to be more muted due to lower nominal GDP growth. The phasing out of the extraordinary measures to cushion households and firms from some of the effects of the higher energy prices is expected to reduce the general government deficit further in 2023 and in particular in 2024.

While inflation may help reduce the debt burden in the short term, higher nominal interest rates increase the cost of rolling over and issuing new debt. Despite the continued decrease in debt ratios, the high level of debt is a risk factor. Higher inflation has a direct debt-reducing impact through the denominator effect over the medium term. However, Commission simulations show that this effect is outweighed by the debt-increasing effects in the case of terms of trade shocks, which result in slower real GDP growth, a weaker primary balance and a higher interest rate ([79]). Already in 2022, financing conditions for sovereigns became less favourable due to rising interest rates Following tighter monetary conditions in 2022, sovereign bond yields increased across the euro area in 2022 from very low or even negative levels. Spreads between euro area countries increased somewhat as markets priced in risk, before stabilising and even declining for some more indebted countries from mid-2022, which was the timing of the introduction of the Transmission Protection Instrument by the ECB (Graph 3.7.2 c). The higher funding cost will affect the rolling over of existing debt or the issuance of new debt. Gross financing needs increased in 2020 in all Member States in response to the COVID-19 pandemic, by some 10 percentage points of GDP on average (Graph 3.7.2 a). In 2021 and 2022 gross financing requirements decreased gradually, mostly thanks to improved (primary) fiscal balances. In 2023

([79]) See European Commission (2023): Report on the Public Finances in EMU, Part 3 Impact of inflation on public finances, Institutional Paper 256, October 2023.

and 2024 they are forecast to recede further albeit at a slower pace, with deficits remaining still relatively high in some Member States.

While the difference between nominal GDP growth and nominal interest rates is helping to reduce debt in all EU countries in 2023, it is forecast to change in 2024 in some countries. Despite the tightening of monetary policy, real interest rates are currently negative and forecast to remain so. Euro area government bond yields remain among the lowest in the world. Bond yields in Member States with high debt levels have risen more strongly but long debt maturities help to cushion the impact. Favourable financing conditions, which have been present in the EU over the last few years, have become tighter. In 2023, the interest rate growth differential, i.e. the difference between the nominal interest rate and nominal GDP growth, is still conducive to reducing the debt-to-GDP burden in all EU countries. By 2024, that 'r-g' differential is forecast to turn positive and thus debt-increasing in a few Member States and close to zero in several others.

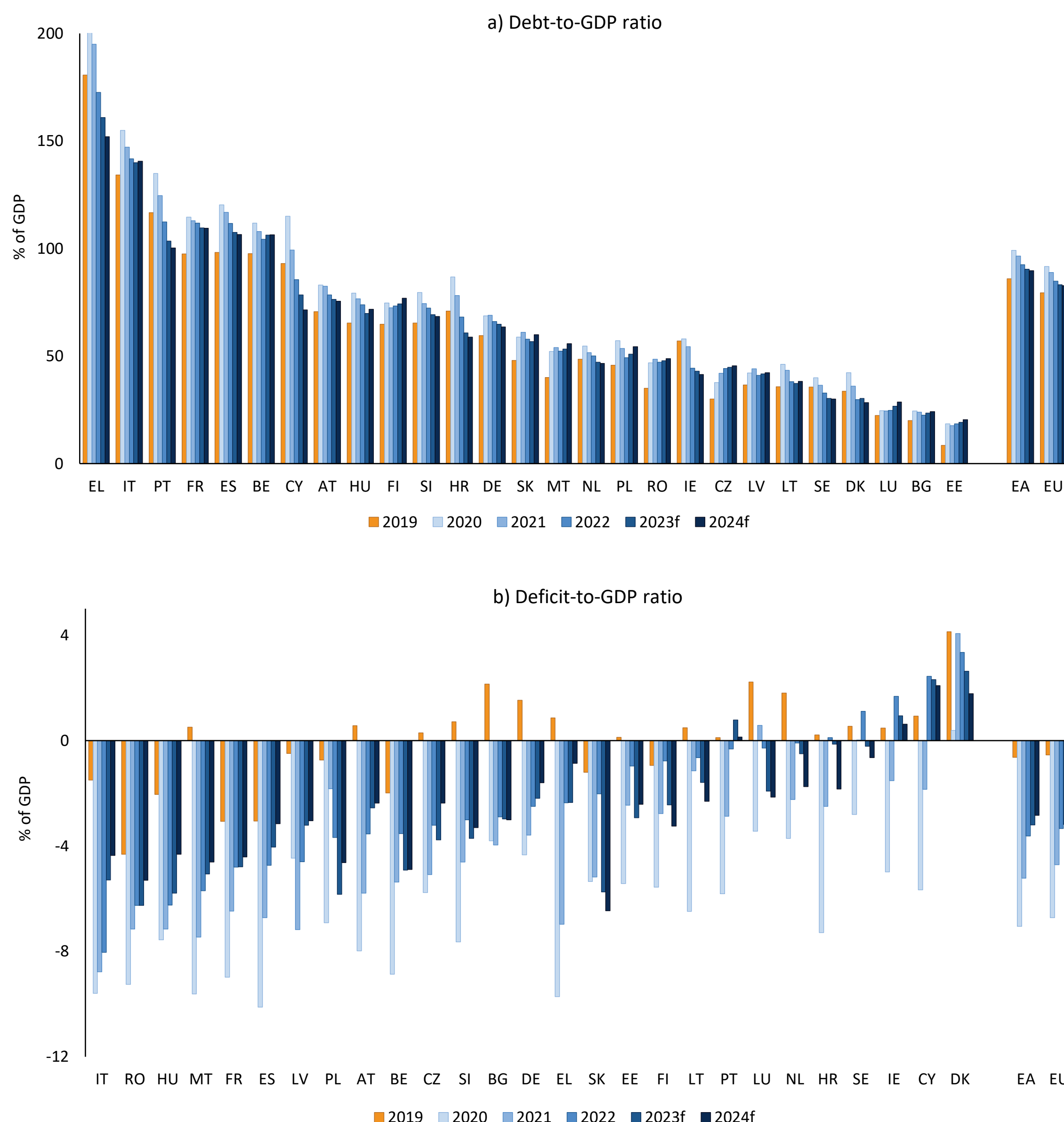
Non-euro area Member States face higher debt servicing costs due to widening sovereign bond yields, while exposure to debt denominated in foreign currencies is a risk in the event of currency depreciation. Prolonged tight financing conditions or exchange rate movements may have a negative impact on the fiscal performance, especially in the non-euro area countries where the share of debt denominated in foreign currency is significant. The global tightening of financing conditions has had a more pronounced, and earlier, impact outside the euro area but it has improved somewhat since the end of 2022 (Graph 3.7.2 c). Sovereign bond yields are especially high in Hungary, Romania and Poland which also have high central bank interest rates. In addition, non-euro area countries have a significant share of government debt denominated in foreign currencies, especially Bulgaria ([80]) (72%), and Romania (54%), but also Hungary (29%).

Government contingent liabilities remain elevated overall, so that stress in the corporate and banking sectors can spill over into the sovereign. Some countries featured significant government contingent liabilities even before the COVID-19 pandemic. During the COVID-19 pandemic, government contingent liabilities increased significantly due to the credit guarantees granted by many governments to the private sector, notably non-financial corporates. As the guarantee schemes were provided to the companies in the COVID-19 pandemic to mitigate the negative implications of the pandemic-related lockdowns, there exist potential risks of a negative feedback loop between the corporate, banking and sovereign sectors (see also Section 3.6). The size of those guarantees is forecast to decline but the risks linked to the contingent liabilities in the banking sector can materialise in some Member States (Graph 3.7.2 b). Bank balance sheets indicate contained vulnerabilities, but stress tests conclude that the implicit risks stemming from contingent liabilities may exist in some Member States in the event of a systemic banking crisis ([81]).

([80]) Bulgaria maintains a fixed exchange rate vis-à-vis the euro via a currency board arrangement and joined ERM II in July 2020.

([81]) Debt Sustainability Monitor 2022 (April 2023)

Graph 3.7.1: **Government debt and government balance**



(1) Countries are presented in decreasing order of the debt-to-GDP and deficit-to-GDP ratios in 2022
Source: AMECO and European Commission

Countries with government debt (% of GDP) above 60% in 2022 in blue																										
BE	BG	CZ	DK	**DE**	EE	IE	**EL**	**ES**	**FR**	**HR**	**IT**	**CY**	LV	LT	LU	**HU**	MT	NL	**AT**	PL	**PT**	RO	**SI**	SK	**FI**	SE

At country level, the following developments are worth highlighting:

- At the end of 2022, the government debt-to-GDP ratios were above 100% in **Greece, Italy, Portugal, Spain, France** and **Belgium** and above 60% in **Austria, Croatia, Cyprus, Finland, Germany, Hungary** and **Slovenia**. The debt-to-GDP ratios decreased in all those Member States in 2022, except Finland, and are forecast to continue decreasing in most of them in 2023 and 2024, apart from Belgium and Finland. In **Bulgaria, Malta, Poland** and **Slovakia** government debt remained below 60% of GDP but the deficits are high and forecast to exceed 3% of GDP in 2023 and 2024, contributing to increasing debt ratios.

- All Member States have been identified as displaying low fiscal sustainability risks ([82]) in the short term. Over the medium term, eight Member States are assessed as facing high fiscal sustainability risks, namely **Belgium, France, Greece, Hungary, Italy, Portugal, Slovakia** and **Spain**.

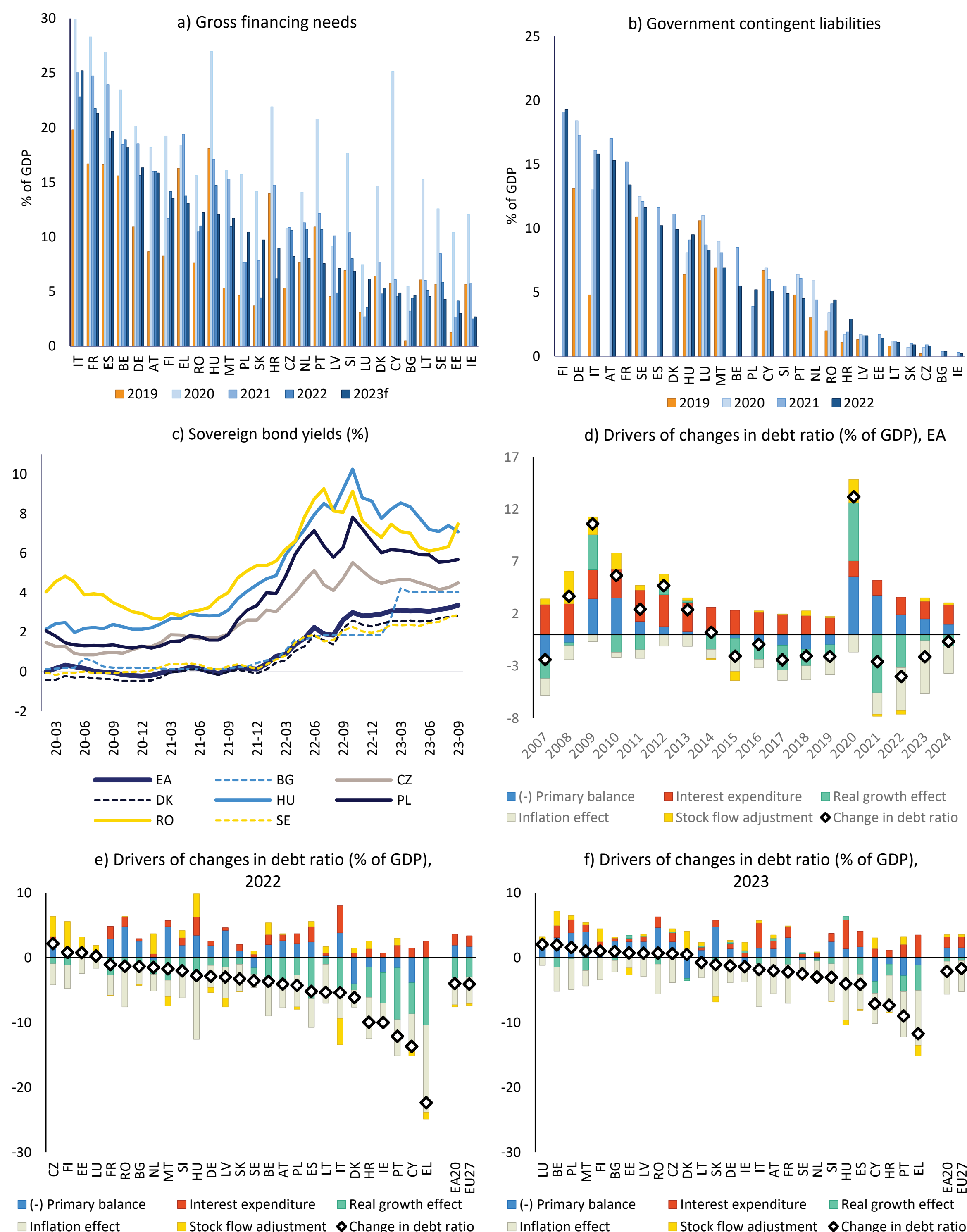
- **Greece** has the highest government debt-to-GDP ratio in the EU and well above 100%, but it is at its lowest level for a decade, and the steady reduction is forecast to continue. The fiscal deficit was sizeable in 2022, but is forecast to improve and gross financing should decrease over the coming years. **Portugal**'s fiscal situation is improving with a declining government debt-to-GDP ratio, benefiting from a strong denominator effect and an improving primary balance. Financing needs are falling to a moderate level. The government balance is forecast to turn positive in 2023, and remain in surplus in both 2024 and 2025. Government debt has been edging down progressively in **France, Italy** and **Spain** mainly thanks to the growth and inflation effects, but still remain above their pre-pandemic levels. In France, however, public debt at unchanged policies is expected to not to fall further as of 2024. As the crisis-related measures are phased out, the fiscal deficits are narrowing but still remain at an elevated level, particularly in Italy. In Italy, the debt ratio is expected to pick up and the r-g differential is forecast to become less favourable in 2024-2025. In Spain, in the absence of policy changes, public debt is expected to continue to reduce in 2023 and 2024, before stabilising in 2025 as a number of revenue-increasing measures are set to expire and drive the slight increase of the general government deficit. **Belgium**'s high government debt decreased in 2022 due to the denominator effect but remains high and is forecast to increase steadily, with the government deficit forecast to remain sizeable over the forecast period. The automatic indexation of wages in the public sector and rising ageing costs put pressure on the public finances. Public finances in **Cyprus** are improving markedly. The government debt-to-GDP ratio decreased again significantly in 2022 as the result of an overall fiscal surplus, and strong real and nominal growth and is below its pre-pandemic level. The fiscal surplus is projected to continue contributing to deleveraging.

- **Romania** and **Hungary** are characterised by persistently high fiscal deficits and government bond yields. Debt denominated in foreign currencies is relevant for both countries, especially the former. In Hungary, government debt is above 60% of GDP and is forecast to recede only marginally and not come under its pre-pandemic level, and the government gross financing needs are high. In Romania, government debt has been somewhat low but is forecast to edge up further. Both Romania's and Hungary's fiscal deficit is forecast to improve but remain high, with the underlying position being substantially weaker in Romania.

- In **Austria, Croatia, Germany** and **Slovenia** the government debt exceeds the 60% of GDP threshold but is forecast to continue decreasing, together with fiscal deficit, to below 60% by 2024 in the case of **Croatia**. Concerns related to the government in **Ireland** remain limited and the debt-to-GDP ratio continues to fall from its moderate level, however the debt relative to gross national income (GNI) is still high. Fiscal surpluses are expected to continue in the coming years. Government debt in **Finland** exceeds 60% of GDP and has been increasing since 2021 and is forecast to rise further. The difference between the interest rate and growth rate is estimated to be positive and the fiscal deficit is also expected to increase but remain below 3% of GDP.

([82]) See the Commission Country Reports 2023 for the latest risk classification and Debt Sustainability Report 2022 (April 2023) for methodological details.

Graph 3.7.2: **Selected graphs on the government sector**



(1) Government contingent liabilities data are not available for some countries for 2020 and 2022. The countries are ranked according to 2022 value (2021 if 2022 is not available).

Source: Eurostat, AMECO and European Commission

4. COUNTRY SECTIONS

BELGIUM

In Belgium, unit labour cost growth is very high and government and private sector debt ratios are also high, although associated macroeconomic risks appear to be limited. Nominal unit labour costs have been increasing substantially and more than in the euro area; core inflation is also above the euro area overall. Government debt is high and is forecast to remain broadly unchanged, reflecting a high deficit. Household and non-financial corporate debt-to-GDP ratios are high but are declining.

Real GDP growth reached 3% in 2022 and is forecast at 1.4% in 2023 and 1.4% in 2024. Headline inflation stood at -1.7% year-on-year in October 2023. This is below the peak of 13.1% recorded in October 2022 and below the euro area average. Core inflation also decreased, from a peak of 6.8% in May 2023, to 5.6% in October 2023, which is above the euro area average. Nominal wages per person grew less than prices in 2022, but are expected to rise faster than prices in 2023.

The scoreboard reading for Belgium shows that three indicators were beyond their indicative thresholds in 2022, namely unit labour costs, private sector debt, and government debt. Relevant developments worth highlighting:

- The **net international investment position** of Belgium remains fairly positive, and concerns about the external position remain limited, despite a deterioration of the current account balance in 2022. The current account is forecast to return to a small surplus in 2023.

- **Cost competitiveness** concerns have increased recently. Nominal unit labour costs increased markedly in 2022 and are expected to grow just as much in 2023, in both years more than in the euro area, driven by the automatic indexation of wages to past inflation. Indexation means that nominal wages are expected to further increase in the future, albeit more moderately. The HICP-based real effective exchange rate was stable in 2022 but appreciated against the euro area. However, it has depreciated in 2023 on account of the now lower headline inflation at home. Core inflation is above the euro area average.

- The **non-financial corporate debt**-to-GDP ratio remains among the highest in the EU, but is on a declining path. It fell to 101% of GDP in 2022 and continued to fall in the first two quarters of 2023. Debt is now 17 percentage points lower than in 2019. Although it remains high and Belgium is characterised by a particularly high and increasing interest rate burden, the substantial share of cross-border intra-group lending in corporate debt reduces risks.

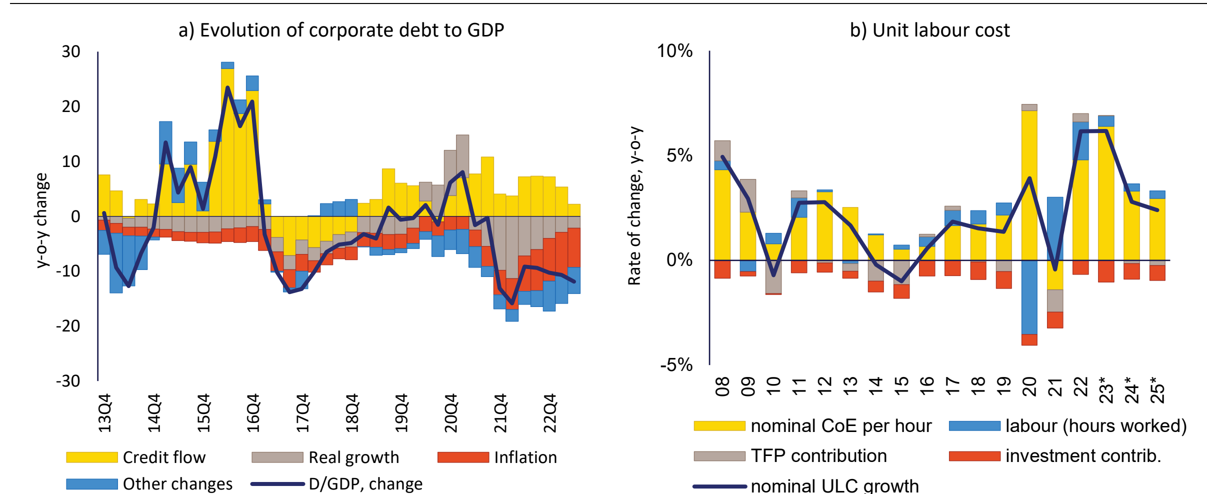
- After a period of steady growth in 2000-2020, the **household debt**-to-GDP ratio is declining on the back of high nominal output growth. It remains high, at 60%, but is set to decrease further in 2023. While it has increased, the cost of borrowing remains moderate at 3.6% in mid-2023. The low share of variable rate mortgages and strong nominal wage growth reduce risks associated with household debt in the short term.

- **House price** growth moderated to 5.6% in 2022 as growth slowed relative to 2021. In 2023, house prices showed the first signs of decline and are expected to moderate further. They have been growing in line with income in the last decade, but are estimated to be overvalued by just over 25%. The **financial sector** remains sound. The Common Equity Tier 1 capital ratio is

close to the EU average, profitability increased in 2022 and the NPL ratio remained low. Credit dynamics slowed down since mid-2022, alongside a tightening of financial conditions.

- Concerns related to Belgium's high **government debt** remain. It decreased in 2022 to 104.3% of GDP as strong growth delivered a marked denominator effect. It is still nearly 7 percentage points above its 2019 level. The government deficit remains high, although it declined to 3.5% in 2022. It is forecast to increase in 2023 and in 2024. Fiscal sustainability risks are high both in the medium and long term ([83]).

Graph 4.1: **Selected graphs: Belgium**



Source: AMECO, Eurostat and European Commission

([83]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.1: **Key economic and financial indicators, Belgium**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	forecast 2023	forecast 2024
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**0.2**	**0.9**	**0.6**	**0.2**	**-0.4**
Current account balance, balance of payments (% of GDP)		0.6 (1)	1.7 (2)	1.4	1.3	-1.0	0.2	-0.2
Net international investment position (% of GDP)	**-35%**	**-82.4 (3)**	**7.8 (4)**	**47.3**	**67.7**	**57.7**	**53.8**	**50.4**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				36.6	36.0	28.8		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**7.0**	**4.9**	**10.1 p**	**12.6**	**16.3**
Nominal unit labour cost index (% y-o-y change)				4.0	-0.4	6.3 p	6.4	2.8
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**2.4**	**0.5**	**1.7**	**-1.6**	**-3.2**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				1.2	0.6	-0.1	-0.9	-1.1
Export market share - % of world exports (5 year % change)	**-6%**			**8.9**	**3.8**	**-1.9**	**-1.7**	**-3.2**
Export market share - % of world exports (1 year % change)				3.7	2.0	-5.3	-1.3	-2.2
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**182.8**	**172.4**	**161.4 p**	**152.6**	**148.5**
Private sector credit flow, consolidated (% of GDP)	**14%**			**-3.0**	**6.2**	**5.7 p**	**1.8**	**1.9**
Household debt, consolidated (% of GDP)		47.3 (6)	55.8 (7)	65.3	62.1	60.0p	57.6	
Non-financial corporate debt, consolidated (% of GDP)		65.2 (6)	46.3 (7)	117.5	110.3	101.4	95.0	
Housing market								
House price index, deflated (1 year % change)	**6%**			**3.3**	**4.5**	**-3.8**	**-1.8**	**0.3**
House price index, nominal (1 year % change)		28.9 (8)		4.2	7.1	5.6	2.8	3.0
Government debt								
General government gross debt (% of GDP)	**60%**			**111.8**	**108.0**	**104.3**	**106.3**	**106.4**
General government balance (% of GDP)				-8.9	-5.4	-3.5	-4.9	-4.9
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**8.0**	**8.1**	**-2.7**	**1.8**	
Return on equity (%)				5.9	9.9	9.9		
Common Equity Tier 1 ratio		10.6 (9)		17.1	17.6	17.3		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				2.1e	1.6e	1.5p	1.5	
Labour market								
Unemployment rate (3 year average)	**10%**			**5.8**	**5.9**	**5.9**	**5.8**	**5.6**
Unemployment rate (year level)		5.8 (10)		5.8	6.3	5.6	5.6	5.6
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.4 b**	**1.1**	**1.4**	**2.3**	**1.3**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-1.0**	**0.0**	**0.2**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-3.5**	**2.2**	**1.9**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

BULGARIA

In Bulgaria, developments related to cost competitiveness, dynamic household borrowing and strong house price growth are of relevance, although associated macroeconomic risks appear to be limited. Nominal unit labour costs are expected to continue to grow strongly and moderate only gradually. Core inflation has been well above the euro area average. Nominal house price growth moderated recently but remains high and house prices show signs of overvaluation.

Real GDP growth reached 3.9% in 2022 and is forecast at 2% in 2023 and 1.8% in 2024. Headline inflation stood at 6.4% year-on-year in September 2023. This is below the peak of 15.6% recorded in September 2022, but above the EU and euro area averages. Core inflation also decreased, from a peak of 11.1% in January 2023, to 7.6% in September 2023, which is also above the EU and euro area averages. Nominal wages per person grew more than prices in 2022, and are expected to also do so in 2023.

The scoreboard reading for Bulgaria shows that one indicator was beyond its indicative threshold in 2022, namely unit labour costs. Relevant developments worth highlighting:

- **Cost competitiveness** concerns persist and are widening. In 2022, nominal unit labour costs increased sharply after several years of marked increases. In contrast, unit labour costs in the manufacturing sector declined on the account of very strong output expansion. For the economy as a whole, unit labour costs are expected to continue to grow strongly in 2023 and increase visibly further in 2024, albeit at a somewhat slower pace. Although wage growth is expected to gradually slow down relative to 2022, it has been the highest in the EU in recent years, reflecting both a tight labour market and a broader nominal convergence process. Core inflation has been high compared with the euro area trading partners and the rest of the EU. Despite recent reductions, differentials vis-à-vis the euro area and the EU remain very significant. The HICP and core inflation-based real effective exchange rates appreciated further in 2022, with nominal appreciation playing only a small role given the currency board arrangement and the large share of trade with the euro area. The appreciating trend has continued in 2023. **External sustainability** concerns are contained, with the current account deficit at 1.4% of GDP in 2022 and a slightly negative net international investment position.

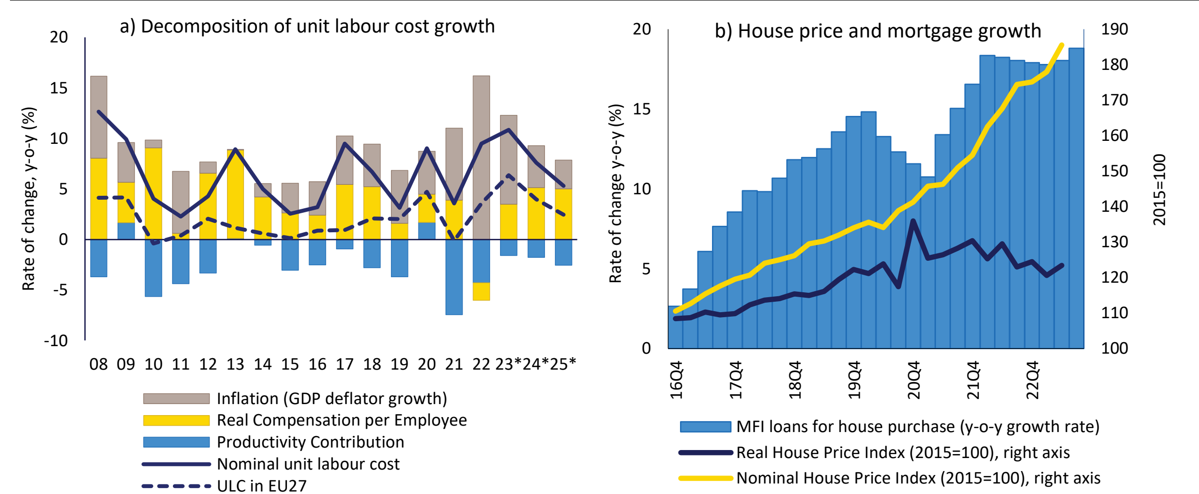
- The **non-financial corporate debt**-to-GDP ratio remains high compared to regional peers but is on a declining path. It fell to 52% in 2022 and continued to fall in the first half of 2023. The share of domestic corporate loans denominated in foreign currency remains very high at 43%. It remained broadly unchanged in the first half of 2023, constituting a potential risk factor. This is nevertheless tempered by Bulgaria's participation in ERM II and the operation of the currency board. Interest rates have been negative in real terms given the high inflation. The corporate non-performing loans ratio decreased in 2022 but remains relatively high.

- The **household debt**-to-GDP ratio is contained and continues to decline, to 23% in 2022, on the back of very high nominal GDP growth. Non-performing loans to households declined further in 2022 but remained relatively high at 4% in mid-2023. Unlike other countries, the cost of borrowing did not increase, remaining broadly stable in 2022 and in the first half of 2023. This resulted in robust net borrowing by households. The predominance of variable rate mortgages linked to deposit interest rates, combined with strong growth in the deposit base and high liquidity in the banking system, largely explain the still low mortgage interest rate. Nevertheless, a reversal in banks' lending policy may materialise, which could be a risk for the household sector.

- **House prices** continue to be a concern, despite some moderation. They have been growing less than incomes since 2013, but are estimated to be overvalued by some 8%. House price growth increased to 13.8% in 2022, although prices still fell in real terms. House price growth rates have moderated since the second half of 2022, coupled with declines in house sales transaction volumes, but house price increases continue to be strong. Housing construction and building permits have been declining.

- In the **banking sector**, the Common Equity Tier 1 capital ratio and return on equity have been above the EU average, with profitability improving in 2022. The non-performing loans ratio declined further to 4.3% in Q4-2022 despite the expiration of private loans moratoria at the end of 2021, but remains above the EU average. Stage 2 loans and forborne loans are high.

Graph 4.2: **Selected graphs: Bulgaria**



Source: AMECO, Eurostat and European Commission

Table 4.2: **Key economic and financial indicators, Bulgaria**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	2023 (forecast)	2024 (forecast)
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**1.0**	**0.1**	**-1.0**	**-0.8**	**-0.3**
Current account balance, balance of payments (% of GDP)		-0.3 (1)	-2.6 (2)	0.0	-1.7	-1.4	0.7	-0.3
Net international investment position (% of GDP)	**-35%**	**-41.3 (3)**	**-19.0 (4)**	**-25.6**	**-18.6**	**-12.9**	**-11.0**	**-6.1**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				47.7	47.4	44.4		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**19.9**	**16.4**	**23.6**	**25.7**	**30.5**
Nominal unit labour cost index (% y-o-y change)				9.0	3.6	9.5	10.8	7.6
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**6.9**	**3.7**	**5.8**	**11.4**	**9.1**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				2.7	0.9	2.1	2.6	-1.2
Export market share - % of world exports (5 year % change)	**-6%**			**15.4**	**11.3**	**15.5**	**13.1**	**10.8**
Export market share - % of world exports (1 year % change)				-0.8	4.4	8.5	-1.9	0.5
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**92.1**	**84.0**	**74.6**	**70.2**	**70.9**
Private sector credit flow, consolidated (% of GDP)	**14%**			**4.2**	**4.9**	**5.9**	**5.5**	**4.7**
Household debt, consolidated (% of GDP)		95.4 (6)	23.5 (7)	24.3	23.8	22.5	22.4	
Non-financial corporate debt, consolidated (% of GDP)		113.2 (6)	47.9 (7)	67.8	60.2	52.1	47.8	
Housing market								
House price index, deflated (1 year % change)	**6%**			**5.2**	**2.5**	**-2.1 b**	**-5.3**	**-0.9**
House price index, nominal (1 year % change)		8.2 (8)		4.6	8.7	13.8b	4.9	3.0
Government debt								
General government gross debt (% of GDP)	**60%**			**24.6**	**23.9**	**22.6**	**23.5**	**24.3**
General government balance (% of GDP)				-3.8	-4.0	-2.9	-3.0	-3.0
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**10.6**	**9.6**	**12.0**	**1.6**	
Return on equity (%)				4.9	8.8	11.2		
Common Equity Tier 1 ratio		10.6 (9)		22.0	22.0	20.4		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				5.9e	4.8e	3.7p	3.3	
Labour market								
Unemployment rate (3 year average)	**10%**			**5.8**	**5.5**	**5.2**	**4.6**	**4.2**
Unemployment rate (year level)		4.2 (10)		6.1	5.3	4.3	4.2	4.2
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.9**	**0.6**	**0.5**	**1.7**	**2.3**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-1.2**	**-1.0**	**-0.6**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**1.3**	**-0.1**	**-1.4**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

CZECHIA

In Czechia, developments related to cost competitiveness and house price developments are of relevance, although associated macroeconomic risks appear to be limited. Nominal unit labour costs have been increasing markedly, but are expected to moderate in the future. Core inflation is high compared to the euro area average, although it is declining fast. Nominal house price growth turned negative recently, but prices are still estimated to be overvalued.

Real GDP growth reached 2.4% in 2022 and is forecast at -0.4% in 2023 and 1.4% in 2024. Headline inflation stood at 8.3% year-on-year in September 2023. This is below the peak of 19.1% recorded in January 2023, but above the EU and euro area averages. Core inflation also decreased, from a peak of 14% in October 2022 to 7.2% in September 2023, which is also above the EU and euro area averages. Nominal wages per person grew less than prices in 2022 and are expected to also do so in 2023.

The scoreboard reading for Czechia shows that three indicators were beyond their indicative thresholds in 2022, namely the real effective exchange rate, export market share, and unit labour costs. Relevant developments worth highlighting:

- **External sustainability** concerns are receding. The current account balance fell from -2.8% in 2021 to -6.1% in 2022, owing to a decrease in the balance of energy and non-energy goods. In the second quarter of 2023, the deficit narrowed to 4.3% and is projected to narrow further to -1.6% in 2023 ([84]). The net international investment position (NIIP) declined from -14.5% in 2021 to -19.7% of GDP in 2022, but is expected to improve by around -2 percentage points in 2023. The NIIP net of non-defaultable instruments remained positive and substantial at 28.4% of GDP in 2022.

- **Cost competitiveness** concerns persist and are widening. Nominal unit labour costs increased markedly further in 2022, and are expected to continue to grow more strongly in 2023. However, the pace of growth should moderate in 2024 as productivity and economic output recover and nominal wage increases slow down. Real wages are falling due to very high inflation, which remains strongly above that of euro area trading partners and the rest of the EU in 2023. Nominal appreciation has been significant since mid-2020, although part of it has been undone since April 2023. The central bank announced that it would end its intervention regime in August 2023, further fuelling the depreciation in 2023. The HICP and core inflation-based real effective exchange rates appreciated further in 2022, and continue to appreciate in 2023 amid higher inflation at home, although inflation is declining fast.

- The **household debt**-to-GDP ratio is low, and has been stable at around 30% since 2010. The small uptick in 2020 has now been reabsorbed. The ratio is set to decline in 2023 on the back of high inflation and a contraction in credit flows as the cost of borrowing more than doubled between mid-2021 and mid-2023. Gross savings rates are below their 2021 peak but above the pre-pandemic level, and are likely to contract somewhat in the future. Non-performing loans to households declined in 2022 from an already low level. The **non-financial corporate** debt-to-GDP ratio decreased to 44% in 2022, and continued falling in the first half of 2023.

- **House prices** are a source of concern as the market adjusts from the very high growth rates of recent years. House prices have been growing faster than incomes in the last decade and

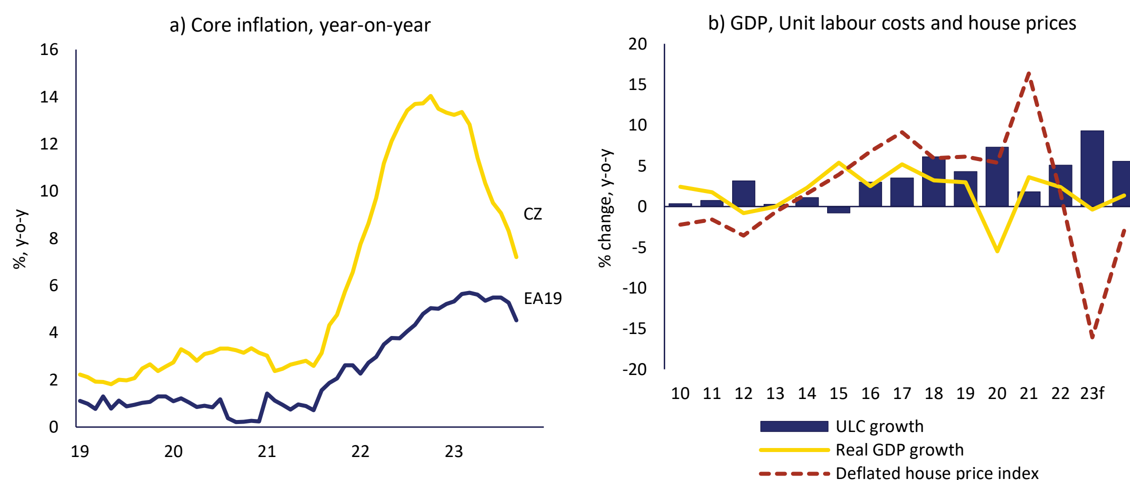
([84]) Quarterly data refer to the four-quarter-moving sum of current account balances.

were estimated to be overvalued by 30-40% (Q4-2022), having posted particularly high growth rates since 2017. In 2022, house price growth was very high at around 17%, moderating in the second half of the year. By Q4-2022, house prices were falling in nominal terms, and this has continued in 2023, although the rate of decrease is moderating. By 2024 house prices are expected to stabilise as the housing market adjusts to the new interest rate environment and long-standing supply constraints continue.

- The **banking sector** is well capitalised and its profitability increased in 2022, well above the EU average. The non-performing loans ratio remains low. A significant increase in lending rates in 2022 has significantly driven down credit, which seems to have contributed to a correction in house prices.

- Fiscal developments remain a cause of concern, although the **government debt**-to-GDP ratio is still relatively low. It reached 44.2% in 2022 after having increased every year since 2020 due to a significant increase in fiscal deficits since the pandemic, despite high nominal GDP growth. The debt ratio is forecast to further increase this and next year. The government deficit narrowed to 3.2% in 2022 and is forecast to increase to 3.8% in 2023 and to start improving from 2024 onwards. The medium- and long-term fiscal sustainability risks are assessed as medium ([85]).

Graph 4.3: **Selected graphs: Czechia**



Source: AMECO, Eurostat and European Commission

([85]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.3: **Key economic and financial indicators, Czechia**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	forecast 2023	2024
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**0.9**	**-0.1**	**-2.3**	**-3.5**	**-2.8**
Current account balance, balance of payments (% of GDP)		0.9 (1)	-2.2 (2)	2.0	-2.8	-6.1	-1.6	-0.6
Net international investment position (% of GDP)	**-35%**	**-62.1 (3)**	**4.2 (4)**	**-16.3**	**-14.5**	**-19.7**	**-17.6**	**-15.2**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				37.3	36.9	28.4		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**18.7**	**13.9**	**14.8**	**16.9**	**21.3**
Nominal unit labour cost index (% y-o-y change)				7.3	1.8	5.1	9.3	5.6
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**5.6**	**5.0**	**13.7**	**16.7**	**10.2**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.8	3.9	8.7	6.0	-2.0
Export market share - % of world exports (5 year % change)	**-6%**			**7.8**	**-1.7**	**-7.7**	**-7.2**	**-7.4**
Export market share - % of world exports (1 year % change)				2.4	-4.8	-5.0	1.4	-1.4
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**81.7**	**78.8**	**76.1**	**71.4**	**71.4**
Private sector credit flow, consolidated (% of GDP)	**14%**			**0.6**	**2.9**	**4.5**	**3.7**	**3.4**
Household debt, consolidated (% of GDP)		52.9 (6)	46.0 (7)	33.9	34.4	32.6	31.0	
Non-financial corporate debt, consolidated (% of GDP)		73.4 (6)	61.6 (7)	47.8	44.4	43.5	40.4	
Housing market								
House price index, deflated (1 year % change)	**6%**			**5.4**	**16.4**	**1.6**	**-14.7**	**-2.9**
House price index, nominal (1 year % change)		35.5 (8)		8.5	19.7	16.9	-6.2	1.0
Government debt								
General government gross debt (% of GDP)	**60%**			**37.7**	**42.0**	**44.2**	**44.7**	**45.5**
General government balance (% of GDP)				-5.8	-5.1	-3.2	-3.8	-2.4
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**4.8**	**7.8**	**3.2**	**0.3**	
Return on equity (%)				6.7	10.6	14.4		
Common Equity Tier 1 ratio		10.6 (9)		20.3	19.8	18.7		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				1.9e	1.7e	1.4p	1.2	
Labour market								
Unemployment rate (3 year average)	**10%**			**2.3**	**2.5**	**2.5**	**2.5**	**2.4**
Unemployment rate (year level)		2.1 (10)		2.6	2.8	2.2	2.4	2.5
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.5**	**0.0**	**0.5**	**1.1**	**1.1**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.4**	**0.1**	**0.0**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**0.1**	**1.5**	**1.2**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

DENMARK

In Denmark, the current account surplus has increased from its previous high level and non-financial corporations and household debt are very high, although associated macroeconomic risks appear to be limited. The current account surplus is the highest in the EU and has increased over the last decade. Although moderating, the surplus is forecast to remain very high. The high share of variable interest rate loans to households are a risk factor amid high debt and falling house prices.

Real GDP growth reached 2.7% in 2022 and is forecast at 1.2% in 2023 and 1.4% in 2024. Headline inflation stood at 0.6% year-on-year in September 2023. This is below the peak of 11.4% recorded in October 2022 and below the EU and euro area averages. Core inflation also decreased, from a peak of 6.1% in February 2023 to 3.6% in September 2023, which is also below the EU and euro area averages. Nominal wages per person grew less than prices in 2022, but are expected to rise broadly in line with prices in 2023.

The scoreboard reading for Denmark shows that two indicators were beyond their indicative thresholds in 2022, namely the current account balance and private sector debt. Relevant developments worth highlighting:

- **External sector** concerns related to the persistently high current account surplus increased. Denmark's current account balance has shown a positive trend in recent years, reaching 13.4% of GDP in 2022, up from an average of 8.6% over 2019-2021. This far exceeds the levels explained by economic fundamentals. The balance of trade in services saw a significant increase, more than compensating for the decrease in the balance of trade in goods. This increase was largely attributed to the exceptional performance of the shipping sector in 2022, benefiting from high transport prices. However, the surplus remains high even after excluding the impact of this sector. The current account balance is forecast to decrease slightly in 2023 and 2024 and to contribute to further rises in Denmark's strongly positive net international investment position (NIIP).

- **Cost competitiveness** concerns remain limited. Nominal unit labour costs increased visibly in 2022. In 2023, unit labour costs are expected to grow less than in euro area trading partners and the rest of the EU. Inflation is below the EU and euro area averages.

- The **non-financial corporate debt**-to-GDP ratio is among the highest in the EU. It decreased to 103% in 2022, but remained broadly unchanged in the first two quarters of 2023. The ratio remains very high but is below its 2019 level. Credit flows to non-financial corporates increased to 11.8% of GDP in 2022, but decelerated substantially in the first half of 2023. The interest rate burden is high and increased recently.

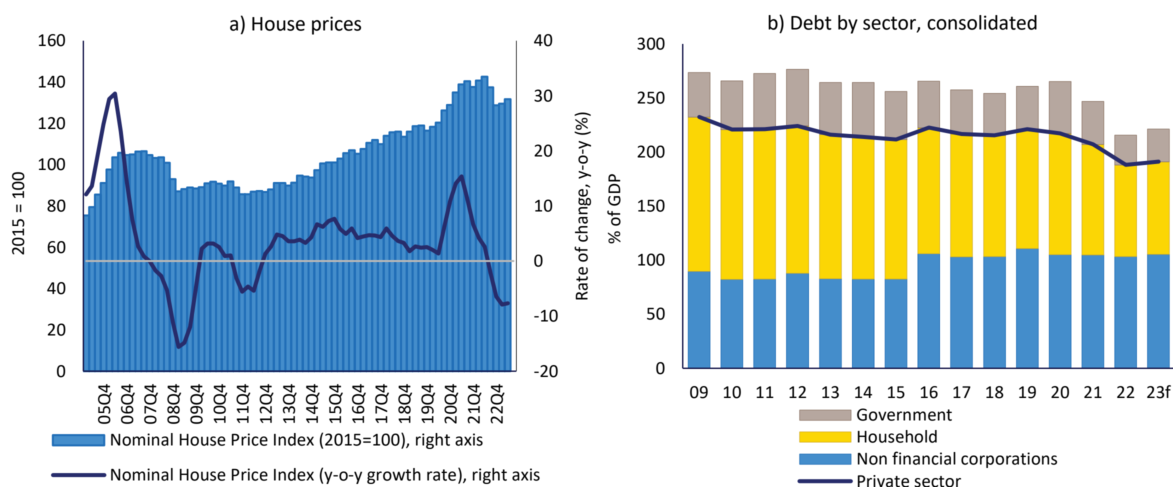
- Despite a strong decline recently, the **household debt**-to-GDP ratio remains among the highest in the EU. It fell to 85% of GDP in 2022. Households' gross savings are robust, at 13% in 2022. Non-performing loans to households declined in 2022 from an already low level. However, the high share of variable rate loans (50% for new loans) constitutes a risk factor, and is associated with high house prices.

- **House prices** started to fall in 2022, following a decade of growing faster than incomes. The reduction in house prices accelerated throughout the year and resulted in a year-on-year reduction of just under 1%, which masks strong quarterly decreases at the end of the year. At the beginning of 2023 the correction in house prices seems to have moderated somewhat. The

estimated overvaluation of 2021 has almost completely corrected, although further decreases in house prices cannot be excluded.

- The **banking sector** is well capitalised and the non-performing loans ratio is low. Profitability significantly decreased in 2022 to well below the EU average. This decrease is driven by one-off legal settlement expenses of one large bank. The ongoing house price correction coupled with high household indebtedness represents a risk for the financial sector. Government debt remains low and fell further in 2022.

Graph 4.4: **Selected graphs: Denmark**



Source: AMECO, Eurostat and European Commission

Table 4.4: **Key economic and financial indicators, Denmark**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	2023 (forecast)	2024 (forecast)
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**7.9**	**8.6**	**10.2**	**10.9**	**11.2**
Current account balance, balance of payments (% of GDP)		0.8 (1)	1.6 (2)	8.1	9.1	13.4	10.3	10.0
Net international investment position (% of GDP)	**-35%**	**-92.8 (3)**	**18.1 (4)**	**69.0**	**72.9**	**58.2**	**70.5**	**79.2**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				32.4	30.9	34.9		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**7.3**	**4.8**	**7.2**	**6.2**	**11.7**
Nominal unit labour cost index (% y-o-y change)				4.2	-1.2	4.2	3.2	3.9
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**0.9**	**-1.1**	**-1.2**	**-6.6**	**-6.7**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				1.6	-0.9	-1.9	-5.3	-1.0
Export market share - % of world exports (5 year % change)	**-6%**			**10.5**	**5.7**	**12.4**	**18.8**	**14.6**
Export market share - % of world exports (1 year % change)				6.7	-2.9	5.6	6.3	-1.4
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**217.1**	**206.9**	**188.0**	**191.0**	**185.6**
Private sector credit flow, consolidated (% of GDP)	**14%**			**5.4**	**11.5**	**13.1**	**1.9**	**1.6**
Household debt, consolidated (% of GDP)		57.6 (6)	77.3 (7)	112.0	102.1	84.8	85.6	
Non-financial corporate debt, consolidated (% of GDP)		83.3 (6)	74.0 (7)	105.1	104.8	103.2	105.4	
Housing market								
House price index, deflated (1 year % change)	**6%**			**4.7**	**9.5**	**-7.4**	**-9.8**	**-2.2**
House price index, nominal (1 year % change)		11.2 (8)		5.1	11.7	-0.5	-6.6	0.0
Government debt								
General government gross debt (% of GDP)	**60%**			**42.3**	**36.0**	**29.8**	**30.3**	**28.4**
General government balance (% of GDP)				0.4	4.1	3.3	2.6	1.8
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**5.6**	**11.6**	**-1.6**	**0.0**	
Return on equity (%)				4.5	8.2	3.8		
Common Equity Tier 1 ratio		10.6 (9)		19.1	18.7	18.7		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				1.9e	1.8e	1.5p	1.4	
Labour market								
Unemployment rate (3 year average)	**10%**			**5.2**	**5.2**	**5.1**	**4.7**	**4.8**
Unemployment rate (year level)		4.5 (10)		5.6	5.1	4.5	4.6	5.2
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**1.1 b**	**1.4**	**1.3**	**1.6**	**0.8**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.3**	**0.0**	**-0.3**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-0.8**	**0.3**	**0.5**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

GERMANY

Germany's large current account surplus moderated substantially in 2022, primarily as a result of much higher energy prices, but is widening again as energy prices recede and domestic demand remains weak. Price and cost competitiveness developments in 2022 contributed to a more symmetric euro area adjustment. Nominal house price growth turned negative in recent quarters, but prices are still estimated to be overvalued.

Real GDP growth reached 1.8% in 2022 and is forecast at -0.3% in 2023 and 0.8% in 2024. Headline inflation stood at 3% year-on-year in October 2023. This is below the peak of 11.6% recorded in October 2022 and slightly above the euro area average. Core inflation also decreased, from a peak of 6.3% in August 2023, to 4.2% in October 2023, which is below the euro area average. Nominal wages per person grew less than prices in 2022 and are expected to also do so in 2023.

The scoreboard reading for Germany shows that three indicators exceeded their indicative thresholds in 2022, namely the current account balance, export market shares and government debt. Relevant developments worth highlighting:

- **External sector** concerns persist. The current account surplus moderated in 2022 and is expected to rebound over the forecast period. The current account balance declined significantly from 7.7% of GDP in 2021 to 4.2% of GDP in 2022. This decrease reflected the impact of a worsening in terms of trade, as well as resilient domestic demand. However, in the first half of 2023, the current account surplus increased to almost 6% of GDP due to higher energy and non-energy goods balances. The current account surplus is forecast to widen to 5.9% in 2023, as domestic demand is declining in real terms. The net international investment position, one of the highest in the EU, is set to continue increasing over the forecast period.

- **Cost competitiveness** developments in 2022 contributed to a more symmetric euro area adjustment. Nominal unit labour costs increased broadly in line with the euro area in 2022 and are expected to grow somewhat faster than the euro area in 2023, largely on account of lower productivity per worker in the face of declining economic activity, with wages increasing at the same pace as in the euro area. The HICP-based real effective exchange rate depreciated in 2022 and has been appreciating in 2023, in both cases largely due to changes in the euro nominal exchange rate. For 2023, headline and core inflation have been above but very close to the euro area average. The core inflation-based real effective exchange rate has appreciated somewhat amid the nominal appreciation of the euro until mid-2023. Export market shares have declined in 2022 and 2023 to a larger extent than in other large euro area countries.

- The **non-financial corporate debt**-to-GDP ratio decreased slightly to 63% in 2022, and continued to fall slightly in the first half of 2023, but remains above its 2019 level. The energy crisis disproportionately affected specific parts of manufacturing branches that may face structural changes. The cost of borrowing of non-financial corporates increased more than in most other euro area countries.

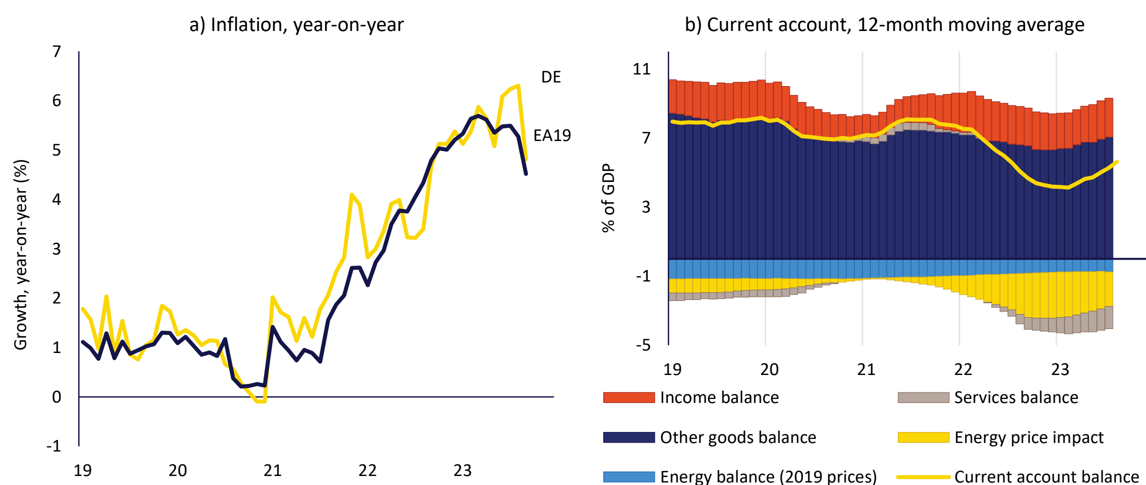
- The **household debt**-to-GDP ratio came down to 55% in 2022 and is set to reach its lowest level in the last two decades in 2023. The high savings rate and low prevalence of variable rate loans reduces risks associated with household debt in the short term, which is concentrated among a small group of mortgage holders.

- **House prices** started to correct in 2022. While they had grown rapidly until early 2022, they have been falling since the middle of 2022 and declined by 9.9% year-on-year in the second quarter of 2023. House prices have been growing substantially above income over the last decade and accelerated over the pandemic. As a result, they are estimated to still be overvalued by about 10%. The correction in house prices may continue in the short term as the market adjusts to higher interest rates and economic prospects appear muted.

- **The banking system** remains sound, with a very low level of non-performing loans, and capital ratios that are in line with the EU average. While its profitability had been suppressed for long, it improved in 2022, while remaining below the EU average. The ongoing correction of residential and commercial real estate prices amidst an increase in lending rates and bleak growth prospects in 2023 represents a challenge for the financial sector, which has considerable exposure to real estate.

- Concerns related to **government debt** remain contained. The government debt-to-GDP ratio exceeds the 60% of GDP threshold, amounting to 66.1% in 2022. It is forecast to decrease in the future, with fiscal sustainability risks in the medium and long term considered medium ([86]). The fiscal deficit narrowed to 2.5% of GDP in 2022 and is forecast to continue decreasing in 2023 and 2024.

Graph 4.5: **Selected graphs: Germany**



Source: AMECO, Eurostat and European Commission

([86]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.5: **Key economic and financial indicators, Germany**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	forecast *2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**7.7**	**7.6**	**6.3**	**5.9**	**5.5**
Current account balance, balance of payments (% of GDP)		1.4 (1)	3.0 (2)	7.1	7.7	4.2	5.9	6.3
Net international investment position (% of GDP)	**-35%**	**-82.9 (3)**	**22.9 (4)**	**63.7**	**68.0**	**70.2**	**73.7**	**77.1**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				54.8	54.1	49.8		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**10.5 p**	**7.0 p**	**7.2 p**	**10.2**	**15.3**
Nominal unit labour cost index (% y-o-y change)				3.5 p	0.1 p	3.4 p	6.5	4.7
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**2.4**	**0.5**	**-0.5**	**-0.4**	**-2.1**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				1.4	0.8	-2.5	1.8	-0.9
Export market share - % of world exports (5 year % change)	**-6%**			**1.6**	**-6.0**	**-13.0**	**-13.3**	**-13.9**
Export market share - % of world exports (1 year % change)				2.0	-4.4	-8.7	-1.7	-1.7
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**120.9 p**	**120.4 p**	**118.4 p**	**112.2**	**109.2**
Private sector credit flow, consolidated (% of GDP)	**14%**			**6.8 p**	**6.8 p**	**6.7 p**	**3.1**	**1.1**
Household debt, consolidated (% of GDP)		47.3 (6)	52.9 (7)	57.0p	56.5p	55.0p	52.2	
Non-financial corporate debt, consolidated (% of GDP)		71.0 (6)	74.7 (7)		63.9	63.4	60.0	
Housing market								
House price index, deflated (1 year % change)	**6%**			**7.2**	**8.3**	**-1.3**	**-5.9**	**-0.6**
House price index, nominal (1 year % change)		17.4 (8)		7.8	11.5	5.3 p	-0.1	2.0
Government debt								
General government gross debt (% of GDP)	**60%**			**68.8**	**69.0**	**66.1**	**64.8**	**63.6**
General government balance (% of GDP)				-4.3	-3.6	-2.5	-2.2	-1.6
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**11.4**	**7.2**	**1.5**	**1.1**	
Return on equity (%)				2.2	4.0	4.3		
Common Equity Tier 1 ratio		10.6 (9)		16.0	15.7	15.9		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				1.2e	1.1e	1.1p	1.1	
Labour market								
Unemployment rate (3 year average)	**10%**			**3.3 b**	**3.5 b**	**3.5 b**	**3.3**	**3.1**
Unemployment rate (year level)		3.1 (10)		3.7 b	3.7	3.1	3.1	3.2
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.3 b**	**1.0**	**1.4**	**2.2**	**1.6**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.4 b**	**-0.2**	**-0.2**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**0.8 b**	**0.4**	**-0.2**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

ESTONIA

In Estonia, cost competitiveness pressures persist, although associated macroeconomic risks appear to be limited. Nominal unit labour costs have been growing sharply. Core inflation is high compared with the euro area overall, although it is declining fast. External sustainability concerns remain limited, and the current account is expected to return to a small surplus this year. Nominal house price growth moderated recently.

Real GDP growth was -0.5% in 2022 and is forecast at -2.6% in 2023 and 1.9% in 2024. Headline inflation stood at 5% year-on-year in October 2023. This is below the peak of 25.2% recorded in August 2022 but above the euro area average. Core inflation also decreased, from a peak of 13% in October 2022 to 6.6% in September 2023, which is also above the euro area average. Nominal wages per person grew less than prices in 2022, but are expected to rise faster than prices in 2023.

The scoreboard reading for Estonia shows that three indicators were beyond their indicative thresholds in 2022, namely the real effective exchange rate, unit labour costs, and the youth unemployment rate. Relevant developments worth highlighting:

- **Cost competitiveness** concerns persist and are widening. After several years of significant increases, nominal unit labour costs accelerated further and grew sharply in 2022, driven by significant nominal wage increases amid labour shortages. In 2023, unit labour costs are expected to continue growing at the highest rate in the euro area. The HICP-based real effective exchange rate appreciated markedly in 2022, including when measured on the basis of core inflation. It is high compared with Estonia's euro area peers, but is declining fast. Appreciation has continued in 2023.

- **External sustainability** concerns remain limited. The current account balance, which had been in surplus before the pandemic, declined to -3.2% in 2022, primarily due to a decline in both the energy and non-energy goods balances. It is expected to return to a small surplus this year due to a lower energy balance and still buoyant export of services.

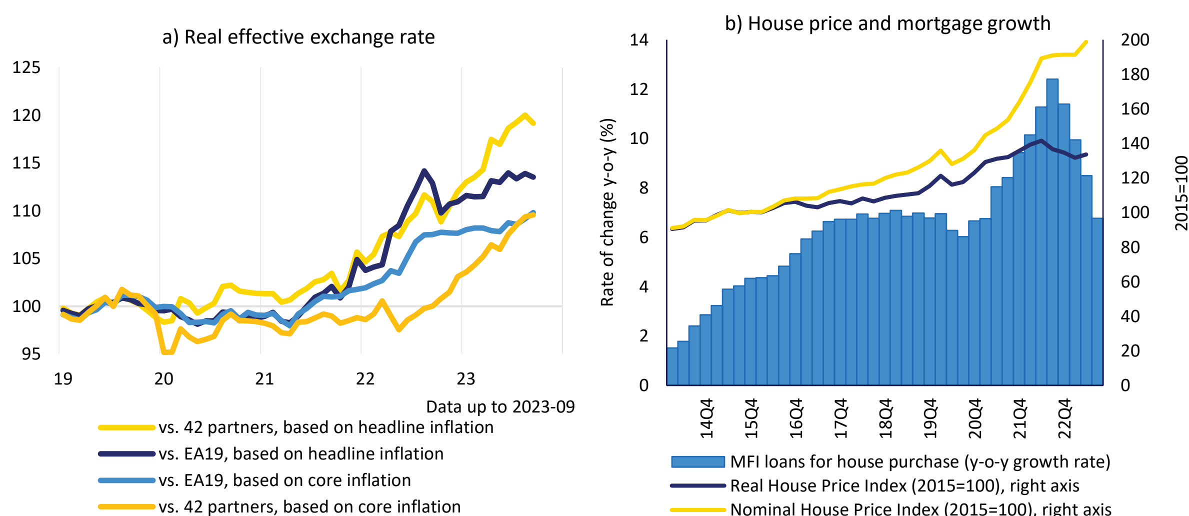
- The **non-financial corporate debt**-to-GDP ratio remains high compared to regional peers. The ratio decreased slightly to 58% in 2022, below its 2019 level. It remained broadly unchanged in the first two quarters of 2023. Credit flows accelerated to 5.7% of GDP in 2022.

- The **household debt**-to-GDP ratio was 37% in 2022 and is set to decrease further in 2023, helped by high nominal GDP growth due to inflation. Credit flows have slowed down as the cost of borrowing doubled between mid-2022 and mid-2023. Risk factors for the household sector include the high prevalence of variable rate loans and the low savings rate.

- Despite a sharp acceleration in **house price growth** at the start of 2022, house prices stabilised towards the end of the year as economic growth faltered. Overall, prices nevertheless increased by 22% in the year as a whole. Despite strong growth, they are estimated to be in line with fundamentals, as growth prior to that was not substantially higher than incomes, limiting the possibility of a correction.

- The **banking sector** remains resilient with one of the lowest non-performing loans ratios and one of the highest capital ratios in the EU, despite the latter's decrease in 2022. Stage 2 loans increased slightly in 2022 and remain rather high. Profitability increased in 2022 and is above the EU average.

Graph 4.6: **Selected graphs: Estonia**



Source: AMECO, Eurostat and European Commission

Table 4.6: **Key economic and financial indicators, Estonia**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	forecast *2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**0.5**	**-0.7**	**-2.6**	**-1.7**	**-0.5**
Current account balance, balance of payments (% of GDP)		-0.8 (1)	-1.7 (2)	-1.9	-2.6	-3.2	0.7	1.1
Net international investment position (% of GDP)	**-35%**	**-58.8 (3)**	**-14.7 (4)**	**-21.0**	**-13.4**	**-20.2**	**-15.8**	**-11.0**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				42.0	41.8	28.7		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**14.6**	**10.0**	**19.0**	**31.9**	**33.3**
Nominal unit labour cost index (% y-o-y change)				2.6	2.1	13.6	13.7	3.2
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**4.9**	**1.9**	**8.8**	**13.9**	**12.8**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.6	1.5	6.5	5.1	0.5
Export market share - % of world exports (5 year % change)	**-6%**			**15.8**	**18.6**	**17.0**	**9.7**	**6.1**
Export market share - % of world exports (1 year % change)				4.5	9.1	-1.5	-4.6	-0.9
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**101.5**	**96.9**	**94.3**	**92.1**	**88.9**
Private sector credit flow, consolidated (% of GDP)	**14%**			**2.9**	**6.8**	**9.2**	**2.8**	**2.1**
Household debt, consolidated (% of GDP)		186.4 (6)	38.5 (7)	40.6	38.4	36.8	36.1	
Non-financial corporate debt, consolidated (% of GDP)		185.8 (6)	61.0 (7)	60.9	58.5	57.5	56.0	
Housing market								
House price index, deflated (1 year % change)	**6%**			**7.0**	**10.4**	**4.5**	**-10.6**	**0.4**
House price index, nominal (1 year % change)		1.6 (8)		6.0	15.1	22.2	-0.7	4.0
Government debt								
General government gross debt (% of GDP)	**60%**			**18.6**	**17.8**	**18.5**	**19.2**	**20.5**
General government balance (% of GDP)				-5.4	-2.5	-1.0	-2.9	-2.4
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**18.0**	**18.5**	**1.6**	**2.2**	
Return on equity (%)				7.4	9.5	10.9		
Common Equity Tier 1 ratio		10.6 (9)		27.0	23.3	20.9		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				1.6e	1.1e	0.8p	0.9	
Labour market								
Unemployment rate (3 year average)	**10%**			**5.6**	**5.9**	**6.2**	**6.3**	**6.5**
Unemployment rate (year level)		6.2 (10)		6.9	6.2	5.6	7.0	6.9
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.4**	**-0.2**	**2.0**	**3.1**	**2.5**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.8**	**0.3**	**0.4**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**6.2**	**4.7**	**7.0**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

IRELAND

In Ireland, external, household and non-financial corporate and government debt-to-GDP ratios are high but continue to decline, and associated macroeconomic risks appear to be limited. Debt ratios in Ireland are affected by the statistical impact of the extensive operations of multinational corporations. Nominal house price growth moderated recently, but housing affordability remains a concern, with household debt being high as a share of household income.

Real GDP growth reached 9.4% in 2022 and is forecast at -0.9% in 2023 and 3.0% in 2024. Headline inflation stood at 3.6% year-on-year in October 2023. This is below the peak of 9.6% recorded in June 2022 but abovlse the euro area average. Core inflation also decreased, from a peak of 5.8% in August 2022 to 4% in September 2023 which is below the euro area average. Nominal wages per person grew less than prices in 2022 and are expected to rise broadly in line with prices in 2023.

The scoreboard reading for Ireland shows that three indicators were beyond their indicative thresholds in 2022, namely the current account balance, net international investment position and private sector debt. Relevant developments worth highlighting:

- **External sustainability** concerns continued to subside. The external sector is inflated by the activities of multinational corporations. The current account surplus declined from 13.7% in 2021 to 10.8% in 2022 mainly due to a deterioration in the service and primary income balances. The net international investment position (NIIP), which had nearly reached -200% of GDP before the pandemic, increased to -116.8% of GDP in 2022. A continued improvement in this position is expected over the forecast period owing to current account surpluses. Cost competitiveness concerns are limited, supported by inflation below the euro area average.

- The **non-financial corporate debt**-to-GDP ratio is one of the highest in the EU, although it is on a declining path. It reached 122%, which corresponds to a more substantial 226% of modified gross national income (GNI*) in 2022. The share of domestic corporate loans denominated in foreign currency is one of the highest among euro area countries, partly due to cross-border intra-group lending. The corporate non-performing loans ratio is moderate, but increased slightly in 2022. Non-financial corporate vulnerabilities are mitigated by a high and increasing profit share and savings, together with the high share of cross-border intra-group lending in corporate debt.

- The **household debt**-to-GDP ratio is low, at 26% of GDP in 2022 and has declined sharply over time. However, Irish GDP is overstated by the activities of multinationals and, when expressed as a share of household gross disposable income, household debt remains high around 95%, despite significant reductions. The cost of borrowing increased recently, albeit less than in other EU countries and credit flows turned weakly positive between mid-2022 and mid-2023 after several years. While the share of variable rate loans is very low among new loans issued, it was high for loans issued earlier (especially before the great financial crisis), exposing a pool of households to interest rate shocks. Banks' non-performing loans to households declined in 2022 by 2 percentage points to 3%.

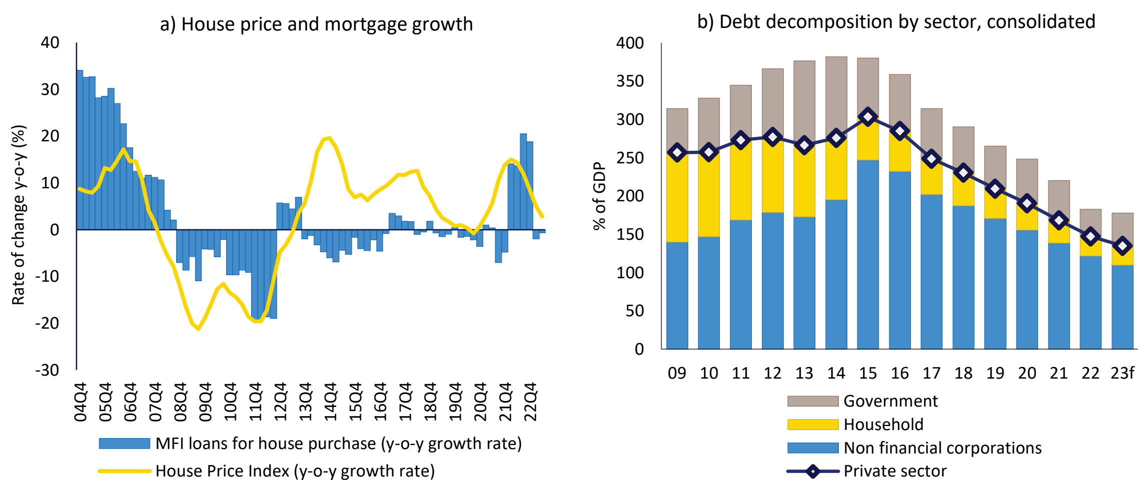
- **House price growth** remains a concern, despite some moderation this year. Over 2022 as a whole, house price growth accelerated, reaching over 12%. However, a moderation in growth rates was evident from the middle of the year and a small reduction took place in the first half

of 2023. Despite strong increases in 2021 and 2022, largely exceeding incomes, house prices do not show signs of overvaluation ([87]). Nevertheless, further increases would be a source of concern, and strong income growth may support the borrowing capacity of households despite higher interest rate.

- The **banking sector** is well capitalised, and the profitability of banks (both domestic retail banks and international investment ones) increased markedly over 2022 and in the first half of 2023, in line with the EU average. The non-performing loans ratio remains very low, but the Stage 2 ratio is rather high and further increased in 2022 and in the first half of 2023. Credit provision remained muted over the same period.

- Concerns related to the **government debt**-to-GDP ratio remain contained and continue to recede. Debt decreased to 44.4% in 2022 and is forecast to continue falling in 2023 and 2024. In contrast, government debt relative to gross national income remains large, at about 90%. The government balance turned into a surplus in 2022 and the surplus is forecast to continue in the future. The long-term fiscal sustainability risks are medium ([88]).

Graph 4.7: **Selected graphs: Ireland**



Source: AMECO, Eurostat and European Commission

([87]) For Ireland the under/overvaluation estimative is affected by the house price of the first decade of this century which contained a large house price boom (followed by a strong correction) and possibly underestimates the current overvaluation gap.

([88]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.7: **Key economic and financial indicators, Ireland**

							forecast	
	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	*2023*	*2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**-7.1**	**-4.2**	**6.0**	**11.5**	**10.4**
Current account balance, balance of payments (% of GDP)		4.7 (1)	0.0 (2)	-6.5	13.7	10.8	9.9	10.6
Net international investment position (% of GDP)	**-35%**	**-168.4 (3)**	**18.1 (4)**	**-165.0**	**-130.9**	**-116.8**	**-106.5**	**-95.6**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-293.8	-323.4	-234.0		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**-6.5**	**-9.4**	**-10.6**	**3.7**	**13.9**
Nominal unit labour cost index (% y-o-y change)				-5.5	-5.5	0.1	9.6	3.8
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**-1.3**	**-2.6**	**-4.6**	**-2.2**	**-3.2**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.3	-0.1	-4.7	1.7	-1.2
Export market share - % of world exports (5 year % change)	**-6%**			**51.7**	**40.4**	**32.1**	**21.1**	**10.4**
Export market share - % of world exports (1 year % change)				23.5	-3.7	-4.7	-2.6	0.0
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**190.3**	**168.1**	**147.1**	**134.9**	**131.5**
Private sector credit flow, consolidated (% of GDP)	**14%**			**-3.8**	**1.9**	**2.0**	**4.3**	**3.9**
Household debt, consolidated (% of GDP)		48.0 (6)	77.9 (7)	34.8	29.7	25.5	25.0	
Non-financial corporate debt, consolidated (% of GDP)		78.3 (6)	94.5 (7)	155.5	138.4	121.6	109.9	
Housing market								
House price index, deflated (1 year % change)	**6%**			**-0.4**	**4.2**	**5.0**	**-1.0**	**-0.3**
House price index, nominal (1 year % change)		-5.9 (8)		0.3	8.3	12.3	5.0	2.9
Government debt								
General government gross debt (% of GDP)	**60%**			**58.1**	**54.4**	**44.4**	**43.0**	**41.4**
General government balance (% of GDP)				-5.0	-1.5	1.7	0.9	0.6
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**7.6**	**18.9**	**-4.0**	**0.4**	
Return on equity (%)				-2.2	4.5	3.3		
Common Equity Tier 1 ratio		10.6 (9)		22.3	22.2	21.3		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				3.4e	2.4e	1.7p	1.6	
Labour market								
Unemployment rate (3 year average)	**10%**			**5.6**	**5.7**	**5.5**	**5.0**	**4.3**
Unemployment rate (year level)		4.6 (10)		5.9	6.2	4.5	4.2	4.2
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**-1.8**	**1.8**	**3.5**	**6.9**	**3.3**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-1.6**	**-0.3**	**-0.3**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**1.4**	**0.7**	**-2.4**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

GREECE

In Greece, concerns related to the external position and government debt remain, although government debt is on a strongly declining path. The current account has been deeply negative and is expected to remain in a substantial deficit in the near future, despite improvements. Nominal house prices have increased strongly last year and this year. Concerns remain about the banking sector, which is burdened by non-performing loans that are still high as a ratio to total loans and have not declined much recently.

Real GDP growth reached 5.6% in 2022 and is forecast at 2.4% in 2023 and 2.3% in 2024. Headline inflation stood at 3.9% year-on-year in October 2023. This is below the peak of 12.1% recorded in September 2022, but above the euro area average. Core inflation also decreased, from a peak of 7.3% in May 2023 to 3.6% in October 2023, which is below the euro area average. Nominal wages per person grew less than prices in 2022, but are expected to rise faster than prices in 2023.

The scoreboard reading for Greece shows that four indicators were beyond their indicative thresholds in 2022, namely the current account balance, net international investment position, government debt and unemployment rate. Relevant developments worth highlighting:

- The **external sustainability** outlook significantly deteriorated and remains a cause for concern. The current account, which stood between -1 to -2% in the most recent years before the pandemic, fell from -6.8% of GDP in 2021 to -10.3% in 2022. Strong investment activity, partially financed via the Recovery and Resilience Facility, will keep it elevated in the following years. The current account is set to remain deeply negative, at -6.7% in 2023 and -5.8% in 2024, far below the estimated norms and prudential benchmarks. The net international investment position (NIIP) improved from -173% in 2021 to -144.2% of GDP in 2022 owing to strong nominal growth and valuation effects, and is expected to improve somewhat in 2023 and 2024.

- **Cost competitiveness** concerns are limited. Nominal unit labour costs were stable in 2022, with nominal wage growth being contained. Unit labour costs are expected to grow somewhat in 2023 and 2024 but by less than in the rest of the euro area. The HICP-based real effective exchange rate depreciated in 2022 and is continuing to do so in 2023. When measured on the basis of core inflation, the real effective exchange rate depreciated in 2022 and is appreciating somewhat in 2023.

- The **non-financial corporate debt**-to-GDP ratio decreased to 56% of GDP in 2022, and declined slightly in the first half of 2023. It is slightly above its 2019 level. Corporate indebtedness is flanked by high corporate liquidity buffers, which mitigate risks.

- The **household debt**-to-GDP ratio declined to 45% in 2022. Net credit flows have been negative for several years and the cost of borrowing has remained relatively high compared to the euro area average, hovering around 3% for the last decade. Non-performing loans to households declined by 1 percentage point in 2022, but remain high at 11%.

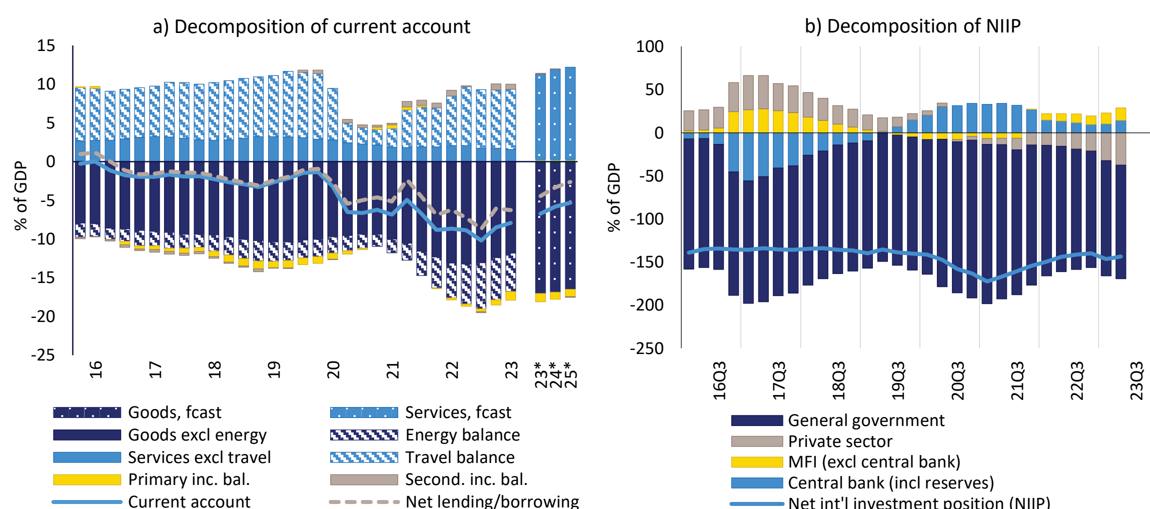
- **House prices** started to rise just before the pandemic on the back of both reviving domestic and foreign demand, and limited supply due to years of subdued construction investment. They increased strongly in 2022, by 11%, and continued rising swiftly in 2023. As a result, there is a risk of house prices have becoming slightly overvalued. They are expected to continue to grow amid strong demand, albeit at a slower pace.

- **The banking sector** situation improved, but some vulnerabilities persist. Return to equity and credit growth turned positive in 2022 after being in negative territory for several years. Profitability was well above the EU average amid an increase in net interest income driven by a widening of the interest rate spread. The Common Equity Tier 1 capital ratio remained stable in 2022, still one of the lowest in the EU. The non-performing loans ratio decreased slightly, but at 6.3% (as of first quarter of 2023) remains the highest in the EU. The reduction of non-performing loans in recent years is notable, but risks have largely migrated to the non-bank financial sector and to a lesser extent to the state. Stage 2 loans and the share of forborne loans are above the euro area average.

- Concerns related to **government debt** remain high, although debt is declining. The government debt-to-GDP ratio is among the highest in the EU, although it fell below its 2019 level to 172.6% of GDP in 2022. Debt is forecast to decrease further in 2023 and 2024, driven by nominal growth and a narrowing deficit. The government deficit narrowed significantly to 2.4% in 2022, as the primary balance turned positive, a year earlier than expected and is forecast to continue improving. As Greece's debt is predominantly held by official lenders at favourable interest rates and long average maturities, interest expenditure is contained in the short and medium term. In addition, Greece continues to hold a sizeable cash buffer that allows for efficient liquidity management and reduces rollover risks. Short and long-term fiscal sustainability risks are low, reflected in the Greek sovereign bonds regaining investment grade in 2023, but are high in the medium term ([89]).

- **Labour market** weaknesses continue to recede. The unemployment rate declined substantially, and is set to continue falling, but at 12.5% in 2022 remains among the highest in the EU. The activity rate is relatively low, albeit increasing. Youth and long-term unemployment rates declined but remain the highest in the EU.

Graph 4.8: **Selected graphs: Greece**



Source: AMECO, Eurostat and European Commission

([89]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.8: **Key economic and financial indicators, Greece**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	forecast 2023	2024
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**-3.7**	**-5.0**	**-7.9**	**-7.9**	**-7.6**
Current account balance, balance of payments (% of GDP)		-0.9 (1)	-1.0 (2)	-6.6	-6.8	-10.3	-6.7	-5.8
Net international investment position (% of GDP)	**-35%**	**-48.4 (3)**	**-46.2 (4)**	**-174.3**	**-173.0**	**-144.2**	**-142.4**	**-141.8**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-155.4	-151.1	-120.7		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**6.0**	**3.7 p**	**3.5 p**	**0.6**	**6.8**
Nominal unit labour cost index (% y-o-y change)				7.0	-3.1 p	-0.2 p	4.0	2.8
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**0.3**	**-3.3**	**-2.5**	**-1.8**	**-2.9**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.3	-1.5	-1.3	-0.1	-2.5
Export market share - % of world exports (5 year % change)	**-6%**			**-10.9**	**8.6**	**12.6**	**9.5**	**10.5**
Export market share - % of world exports (1 year % change)				-19.7	19.3	8.9	4.5	1.4
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**125.6**	**122.0 p**	**100.8 p**	**93.2**	**98.1**
Private sector credit flow, consolidated (% of GDP)	**14%**			**5.5**	**0.8 p**	**1.1 p**	**5.5**	**9.4**
Household debt, consolidated (% of GDP)		27.3 (6)	30.2 (7)	59.6	55.6p	45.2p		
Non-financial corporate debt, consolidated (% of GDP)		48.4 (6)	53.4 (7)	66.0	66.4	55.6		
Housing market								
House price index, deflated (1 year % change)	**6%**			**5.7 e**	**6.5 e**	**4.4 e**	**-0.7**	**1.2**
House price index, nominal (1 year % change)		5.7 (8)		4.5	7.6	11.1	3.1	4.0
Government debt								
General government gross debt (% of GDP)	**60%**			**207.0**	**195.0**	**172.6**	**160.9**	**151.9**
General government balance (% of GDP)				-9.7	-7.0	-2.4	-2.3	-0.9
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**27.7**	**14.3**	**-0.5**	**-1.7**	
Return on equity (%)				-7.9	-20.1	12.7		
Common Equity Tier 1 ratio		10.6 (9)		15.0	13.6	14.4		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				26.5e	8.6e	6.2p	6.2	
Labour market								
Unemployment rate (3 year average)	**10%**			**18.4**	**16.7**	**14.9**	**12.9**	**11.5**
Unemployment rate (year level)		9.5 (10)		17.6	14.7	12.5	11.4	10.7
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**-2.9**	**-0.8**	**0.9**	**5.4**	**4.0**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-3.8**	**-3.3**	**-3.6**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-6.5**	**-5.7**	**-6.1**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

SPAIN

In Spain, concerns related to household and non-financial corporate debt, government debt, and external debt remain, but debt ratios have continued declining further. Strong nominal GDP growth has helped the resumption of the broad deleveraging process by the private sector, , and to a lesser extent by the public sector. The external sector is posting current account surpluses that further support debt reduction.

Real GDP growth reached 5.8% in 2022 and is forecast at 2.4% in 2023 and 1.7% in 2024. Headline inflation stood at 3.5% year-on-year in October 2023. This is well below the peak of 10.7% recorded in July 2022 but above the euro area average. Core inflation also decreased, from a peak of 5.2% in February 2023 to 3.9% in September 2023, which is below the euro area average. Nominal wages per person grew less than prices in 2022, but are expected to rise faster than prices in 2023.

The scoreboard reading for Spain shows that five indicators were beyond their indicative thresholds in 2022, namely the net international investment position, export market share, nominal unit labour cost, government debt, and the unemployment rate. Relevant developments worth highlighting:

- **External sustainability** concerns have continued to abate. The current account surplus posted 0.6% of GDP in 2022, down from 0.8% of GDP in 2021, primarily driven by a larger energy deficit. The current account surplus increased to 2% in the second quarter of 2023, underpinned by higher goods and services balances. While the travel balance is approaching the levels recorded in 2019, non-tourism services also expanded markedly. The net international investment position, at -60.2% of GDP in 2022, experienced a notable improvement compared to previous years, with further increases expected for 2023 and 2024.

- **Cost competitiveness** concerns remain limited. Nominal unit labour costs grew very little in 2022 against a backdrop of productivity gains in times of a marked expansion of output and contained nominal wage growth. Nominal unit labour costs are expected to grow somewhat more in 2023, amid higher wage increases, but still by less than in the euro area. The HICP and core inflation-based real effective exchange rates depreciated in 2022. Export market shares edged up significantly in 2022, and offset some of the losses recorded in previous years, especially during the COVID-19 crisis in 2020.

- Vulnerabilities related to the high **non-financial corporate debt**-to-GDP ratio remain, although the ratio is on a declining path. It moderated to 71% in 2022, slightly below its 2019 level, and continued improving in the first two quarters of 2023. The non-performing loans ratio for the corporate sector was moderate and further decreased in 2022 and in the first half of 2023. Bankruptcies continued to increase in the first half of 2023, although starting from low levels.

- The **household debt**-to-GDP ratio is on a steady downward trend. It reached 52% in 2022 and has since decreased further to its lowest level since 2002. As a result of the tightening of financing conditions that started last year, the cost of borrowing for new mortgages doubled between mid-2022 and mid-2023. The impact on existing loans is partially mitigated by the low incidence of floating rate mortgages among new loans, as only 21% of new loans have a fixation period below 1 year, down from 68% a decade ago. At the same time, the stock of existing mortgages with variable rates remains significant. Non-performing loans kept decreasing in 2022 but still make up more than 3% of all household loans. House price growth accelerated to 7.4% in 2022, contributing to house prices being overvalued by around 15%. In

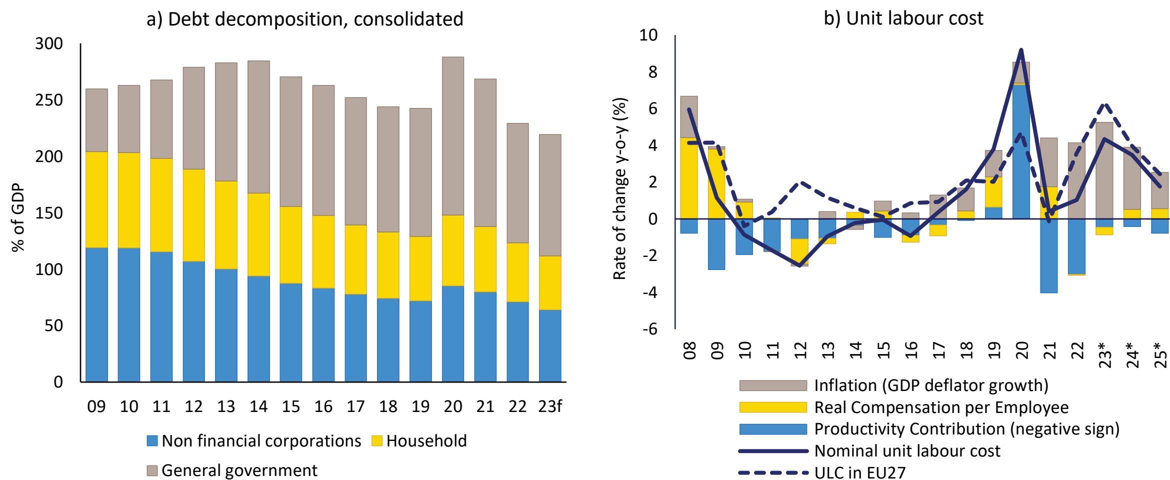
recent quarters, however, house price growth has moderated on the back of higher interest rates and falling transactions.

- The **banking sector** remained resilient. Profitability exceeded the EU average in 2022 but capitalisation remains one of the lowest in the EU. The non-performing loans ratio was stable at 2.7% as of the first quarter of 2023, above the EU average, while the ratio of Stage 2 loans remains on a declining trend.

- Concerns related to **government debt** remain high, but the public debt ratio has kept falling in recent years, reaching 111.6% of GDP in 2022. It is forecast to moderate further in 2023 and 2024, to 107.5% and 106.5%, respectively. The government deficit narrowed to 4.7% in 2022. It is projected to further decrease in 2023 to 4.1%, and in 2024, to 3.2%, still above 3% of GDP. Fiscal sustainability risks are high in the medium term and medium in the long term, primarily due to the high level of public debt and the unfavourable initial budgetary position, as well as the effects of population ageing on pension and health expenditure ([90]).

- **Labour market** weaknesses continue to recede. The unemployment rate remains the highest in the EU, at 12.9% in 2022, although it has declined substantially over the past decade, and is forecast to continue decreasing in 2023 and 2024. Youth and long-term unemployment rates remain among the highest in the EU, despite the recent falls. Moreover, the share of temporary employees in the private sector continued to fall following the 2021 labour market reform included in the recovery and resilience plan, while they remain high in the public sector.

Graph 4.9: **Selected graphs: Spain**



Source: AMECO, Eurostat and European Commission

([90]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.9: **Key economic and financial indicators, Spain**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	2023 (forecast)	2024 (forecast)
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**1.5**	**1.2**	**0.7**	**1.1**	**1.4**
Current account balance, balance of payments (% of GDP)		0.9 (1)	-1.1 (2)	0.6	0.8	0.6	1.9	1.7
Net international investment position (% of GDP)	**-35%**	**-60.1 (3)**	**-20.2 (4)**	**-84.9**	**-71.0**	**-60.2**	**-53.3**	**-48.2**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-52.2	-39.6	-30.2		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**15.2**	**13.8 p**	**10.8 p**	**5.9**	**9.1**
Nominal unit labour cost index (% y-o-y change)				9.2	0.4 p	1.0 p	4.3	3.5
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**1.0**	**-0.5**	**-0.7**	**-2.1**	**-3.3**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.6	0.6	-1.9	0.3	-0.6
Export market share - % of world exports (5 year % change)	**-6%**			**-7.4**	**-12.1**	**-7.8**	**-5.9**	**-5.5**
Export market share - % of world exports (1 year % change)				-10.6	0.4	5.1	0.8	-0.7
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**147.9**	**137.7 p**	**123.5 p**	**111.8**	**107.9**
Private sector credit flow, consolidated (% of GDP)	**14%**			**4.8**	**3.0 p**	**0.3 p**	**1.0**	**1.5**
Household debt, consolidated (% of GDP)		39.5 (6)	41.9 (7)	62.6	57.6p	52.3p	47.5	
Non-financial corporate debt, consolidated (% of GDP)		55.9 (6)	44.4 (7)	85.3	80.1	71.2	64.3	
Housing market								
House price index, deflated (1 year % change)	**6%**			**2.1**	**1.4**	**0.8**	**-1.1**	**-0.3**
House price index, nominal (1 year % change)		13.6 (8)		2.2	3.7	7.4	2.5	3.0
Government debt								
General government gross debt (% of GDP)	**60%**			**120.3**	**116.8**	**111.6**	**107.5**	**106.5**
General government balance (% of GDP)				-10.1	-6.7	-4.7	-4.1	-3.2
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**10.5**	**6.3**	**-4.5**	**0.2**	
Return on equity (%)				-3.5	10.2	9.9		
Common Equity Tier 1 ratio		10.6 (9)		13.2	13.3	13.0		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				2.8e	2.9e	2.7p	2.7	
Labour market								
Unemployment rate (3 year average)	**10%**			**15.0**	**14.8 d**	**14.4 d**	**13.3**	**12.2**
Unemployment rate (year level)		12.3 (10)		15.5	14.8 d	12.9 d	12.1	11.6
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**-1.7**	**0.0 d**	**0.2 d**	**1.8**	**0.3**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-2.7**	**-0.2 d**	**-0.3 d**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-0.3**	**0.5 d**	**-2.7 d**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

FRANCE

In France, concerns related to cost competitiveness and government debt remain. Nominal unit labour costs grew visibly in 2022. However, core inflation has been lower than in the euro area average. The government debt-to-GDP ratio has been declining somewhat, but the government deficit remains high. Private sector debt remains high despite recent declines.

Real GDP growth reached 2.5% in 2022 and is forecast at 1.0% in 2023 and 1.2% in 2024. Headline inflation stood at 4.5% year-on-year in October 2023. This is below the peak of 7.3% recorded in February 2023 but above the euro area average. Core inflation also decreased, from a peak of 4.7% in April 2023 to 3.5% in October 2023, which is below the euro area average. Nominal wages per person grew broadly in line with prices in 2022, and are expected to rise less than prices in 2023.

The scoreboard reading for France shows that four indicators were beyond their indicative thresholds in 2022, namely the export market share, unit labour costs, private sector debt and government debt. Relevant developments worth highlighting:

- **External sustainability** concerns remain contained, although close monitoring is warranted. The current account shifted from a surplus of 0.4% of GDP in 2021 to a deficit of 2% in 2022, primarily due to a deterioration in the energy goods balance. 2023 data show only a minor improvement as a deterioration in the services balance counteracts the increase in the goods balance. The forecast is for the current account deficit to decrease to its pre-pandemic levels in 2023 and remain largely stable in 2024. The net international investment position (NIIP) improved to -23.8% of GDP in 2022, after having worsened markedly in the last 5 years. Looking ahead, the position is projected to remain around its 2022 level over the forecast period.

- **Cost competitiveness** concerns remain. Nominal unit labour costs grew visibly in 2022 amid stagnant productivity and notable nominal wage rises in response to high inflation. In 2023, unit labour costs are expected to grow further, but are slightly behind the euro area. The HICP-based real effective exchange rate depreciated significantly in 2022 owing to lower inflation at home, including vis-à-vis the rest of the euro area, and to some depreciation of the euro. It is appreciating in 2023 before depreciating somewhat over the forecast period. When measured on the basis of core inflation, the real effective exchange rate depreciated in 2022, and is showing some appreciation in 2023 on account of the nominal appreciation of the euro. Export market shares declined in 2022. They are expected to stabilise in 2023, before declining further in 2024.

- The **non-financial corporate debt**-to-GDP ratio remains among the highest in the EU, but it has been declining recently. It declined to 98% in 2022, and continued falling in the first two quarters of 2023 amidst positive credit flows, at 5.5% of GDP, which have slowed down recently. Nevertheless, the debt ratio remains around 7 percentage points. higher than before the pandemic, when debt increased sharply. However, corporate indebtedness is flanked by high corporate liquidity buffers, mitigating risks.

- After a period of steady growth up to 2020, the **household debt**-to-GDP ratio declined to 66% in 2022 and is forecast to continue doing so, while remaining high and above the pre-pandemic level in 2023, in contrast with most other EU countries. High nominal output growth has driven the recent reduction, more recently complemented by a strong deceleration in credit flows. The cost of borrowing remains among the lowest in the EU. Recent 2021 Household Finance and

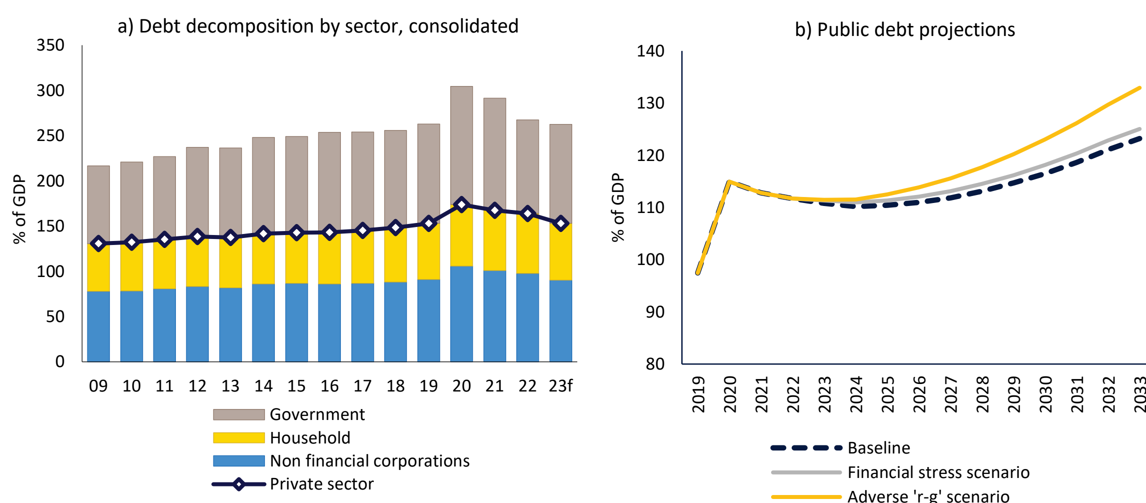
Consumption Survey data suggest that the debt-service-to-income ratio is higher in France than in most other euro area countries. Risks are mitigated by the high share of loans at fixed rates, recent reforms that introduced more prudent lending standards and macroprudential policy measures. Gross savings also remain relatively high.

- **House price** growth was solid in 2022, at 6.3%, but in-year data show that price falls are underway. Following sustained growth in recent years, house prices are estimated to be overvalued by nearly 20%, and some correction is expected, as house prices adjust to higher interest rates.

- The capitalisation of the **banking sector** remained below the EU average as did profitability, which even declined slightly in 2022. The NPL ratio has been close to the EU average, but Stage 2 loans increased. Credit growth remains one of the most stable in the EU. The correction of commercial real estate prices warrants attention given the relatively high exposure of the banking sector.

- Concerns related to **government debt** remain high. The high government debt-to-GDP ratio decreased slightly in 2022 to 111.8% of GDP and is forecast to edge down marginally over the forecast period, while remaining above the 2019 level. The government deficit remains high, although it narrowed to 4.8% in 2022. It is expected to remain at that level in 2023, before declining moderately again in 2024 while staying significantly above 3%. Fiscal sustainability risks remain high in the medium term and medium in the long term ([91]).

Graph 4.10: **Selected graphs: France**



Source: AMECO, Eurostat and European Commission

([91]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.10: **Key economic and financial indicators, France**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	forecast *2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**-0.6**	**-0.2**	**-1.1**	**-0.7**	**-1.0**
Current account balance, balance of payments (% of GDP)		0.1 (1)	-0.8 (2)	-1.6	0.4	-2.0	-0.5	-0.6
Net international investment position (% of GDP)	**-35%**	**-75.7 (3)**	**6.4 (4)**	**-29.4**	**-30.9**	**-23.8**	**-23.7**	**-23.8**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-41.9	-39.3	-33.4		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**4.5**	**5.0 p**	**11.1 p**	**12.3**	**13.4**
Nominal unit labour cost index (% y-o-y change)				4.4	1.3 p	5.1 p	5.5	2.3
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**2.6**	**-0.5**	**-3.8**	**-3.8**	**-4.3**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				1.5	-0.4	-4.7	1.3	-1.0
Export market share - % of world exports (5 year % change)	**-6%**			**-8.6**	**-11.8**	**-10.7**	**-10.7**	**-10.9**
Export market share - % of world exports (1 year % change)				-6.9	-1.4	-1.9	0.3	-1.3
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**173.9**	**167.5 p**	**163.9 p**	**153.0**	**150.8**
Private sector credit flow, consolidated (% of GDP)	**14%**			**13.5**	**6.7 p**	**8.7 p**	**5.2**	**3.9**
Household debt, consolidated (% of GDP)		39.7 (6)	61.6 (7)	68.2	66.6p	66.2p	62.8	
Non-financial corporate debt, consolidated (% of GDP)		45.6 (6)	62.5 (7)	105.7	100.9	97.7	90.2	
Housing market								
House price index, deflated (1 year % change)	**6%**			**4.1**	**4.8**	**1.5**	**-3.8**	**-1.0**
House price index, nominal (1 year % change)		20.2 (8)		5.2	6.3	6.3	2.3	2.0
Government debt								
General government gross debt (% of GDP)	**60%**			**114.6**	**112.9**	**111.8**	**109.6**	**109.5**
General government balance (% of GDP)				-9.0	-6.5	-4.8	-4.8	-4.4
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**11.7**	**8.3**	**-1.3 p**	**2.5**	
Return on equity (%)				4.1	7.1	6.1		
Common Equity Tier 1 ratio		10.6 (9)		16.0	16.2	15.8		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				2.2e	1.9e	1.8p	1.9	
Labour market								
Unemployment rate (3 year average)	**10%**			**8.5**	**8.1 d**	**7.7 d**	**7.5**	**7.3**
Unemployment rate (year level)		8.1 (10)		8.0	7.9 d	7.3 d	7.2	7.4
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**-0.4**	**0.2 d**	**1.0 d**	**2.3**	**1.6**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-1.0**	**-0.2 d**	**-0.3 d**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-2.0**	**-3.1 d**	**-3.4 d**		

Notes: See Annex 1
Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

CROATIA

In Croatia, cost competitiveness pressures have increased recently and house prices have grown strongly in nominal terms. Nominal unit labour costs are expected to accelerate in 2023 and core inflation has been above the euro area overall. Nominal house price growth remains high. Overall associated macroeconomic risks appear to be limited. External sustainability concerns are limited.

Real GDP growth reached 6.3% in 2022 and is forecast at 2.6% in 2023 and 2.5% in 2024. Headline inflation stood at 6.7% year-on-year in October 2023. This is below the peak of 13% recorded in November 2022 but above the euro area average. Core inflation also decreased, from a peak of 11.3% in January 2023, to 7.4% in October 2023, which is also above the euro area average. Nominal wages per person grew more than prices in 2022 and are expected to also do so in 2023.

The scoreboard reading for Croatia shows that one indicator was beyond its indicative threshold in 2022, namely government debt. Relevant developments worth highlighting:

- **External sustainability** concerns remained contained. The current account shifted from a surplus of 1.0% to a deficit of 2.8% in 2022. The travel balance performed well, surpassing its 2019 level. The current account balance increased to -1.1% in the second quarter of 2023 and is expected to increase further, as the negative terms of trade shock abate. A current account balance of 2.6% is projected for 2024. The net international investment position (NIIP) improved, moving from -33% in 2021 to -25% of GDP in 2022, owing to nominal growth, valuation effects, and net transaction effects excluding investment income. The NIIP net of non-defaultable instruments was 14% of GDP. The NIIP is expected to improve further in 2023 and 2024.

- **Cost competitiveness** concerns have increased recently. Nominal unit labour costs increased significantly in 2022, visibly more than the euro -area or EU averages. The unit labour costs growth is also expected to stay high in 2023. However, as this growth in the euro area should also speed up, the relative change should be more contained. The HICP-based real effective exchange rate depreciated very marginally in 2022 but has then appreciated more clearly in 2023. The core inflation-based real effective exchange rate recorded a recent but relatively significant appreciation too. In both cases, nominal appreciation vis-à-vis trade partners, as well as higher inflation led to real appreciation. Export market shares continued increasing strongly in 2022, both for goods and services.

- The **household debt**-to-GDP ratio is low, at 31% in 2022, following a longer-term decline. Unlike other countries in the EU, credit flows continued to grow in 2023 as the cost of borrowing increased only slightly, amid a weak pass-through of monetary tightening and a positive impact of euro adoption on risk perception. The share of highly variable rate loans among new loans dropped from 71% in mid-2013 to almost zero by mid-2023. Non-performing loans declined but still make up more than 4% of all loans to households up to Q2-2023. The non-financial corporate debt-to-GDP ratio decreased in 2022 to 49% of GDP and remained broadly unchanged in the first half of 2023. Credit flows accelerated to 4.4% of GDP in 2022 and accelerated further in the first half of 2023.

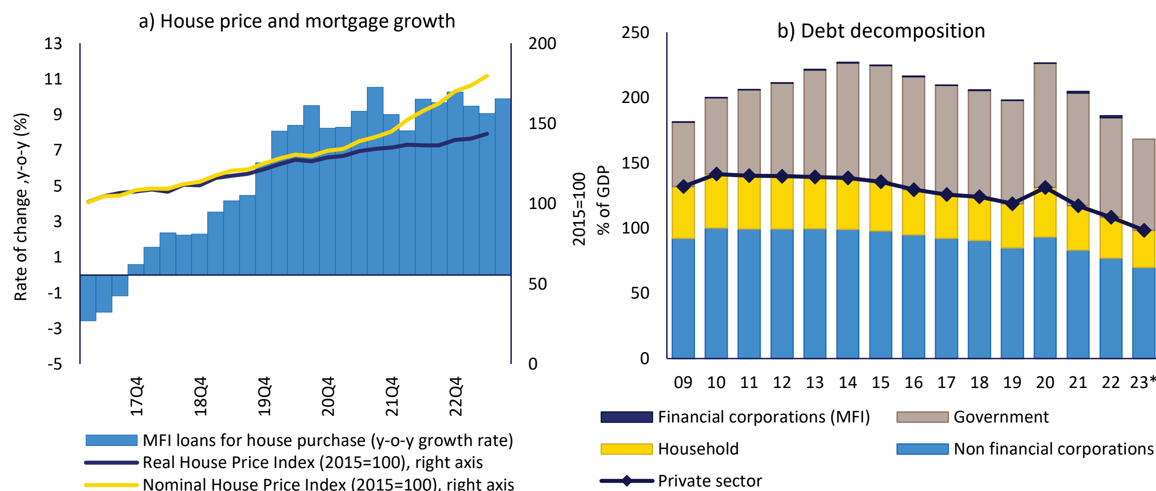
- **House price** growth remains a concern as prices continue to grow strongly, further deteriorating affordability. Nominal house price growth accelerated to nearly 15% over 2022, and continued to grow strongly in 2023. In real terms house price growth continued its slow deceleration to 3.2%. The latest quarterly data show some moderation, but nominal growth

remains strong. House price growth has been substantial since just before the pandemic. However, while house prices are estimated to be broadly in line with the fundamentals, housing affordability is among the lowest in the EU. House prices are expected to continue to grow at the annual level in 2023 albeit at a somewhat slower pace. Growth is expected to stall in 2024, with real prices declining slightly. A government programme of subsidised mortgages that has been contributing to house price growth in recent years, including in 2023, is legislated to end by the end of the year.

- The **banking sector** is stable. The non-performing loans ratio dropped to 3% (as of first quarter 2023), but remains above the euro -area average. Stage 2 loans have been on an increasing trend since 2020, but declined a little in the first quarter of 2023. Bank profitability further increased in 2022 and is above the EU average. The Common Equity Tier 1 capital ratio also declined slightly in 2022, but is still one of the highest in the EU. Credit growth has been slowing down, but remains strong.

- Concerns related to **government debt** are declining. The government debt-to-GDP ratio decreased significantly to 68.2% in 2022, falling below its 2019 level. It is forecast to decrease further in 2023 and 2024 to just below 59% of GDP. Sovereign bond yield spreads have decreased but remain above the euro -area average. The fiscal balance reached a surplus of 0.1% of GDP in 2022 but is forecast to turn into a small deficit in 2023, which is set to widen in 2024. Fiscal sustainability risks are medium in the medium- term ([92]).

Graph 4.11: **Selected graphs: Croatia**



Source: AMECO, Eurostat and European Commission

([92]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.11: **Key economic and financial indicators, Croatia**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	forecast 2023	2024
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**1.0**	**0.8**	**-0.9**	**0.2**	**0.7**
Current account balance, balance of payments (% of GDP)		-0.2 (1)	-2.1 (2)	-1.0	1.0	-2.8	2.4	2.6
Net international investment position (% of GDP)	**-35%**	**-51.9 (3)**	**-21.1 (4)**	**-45.2**	**-32.5**	**-25.4**	**-16.5**	**-18.3**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				2.5	10.8	13.5		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**13.5**	**3.6**	**11.0 p**	**11.5**	**21.9**
Nominal unit labour cost index (% y-o-y change)				9.4	-5.4	7.2 p	9.9	3.4
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**0.5**	**-1.5**	**-0.6**	**5.7**	**4.4**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				-0.5	0.5	-0.6	3.0	-0.7
Export market share - % of world exports (5 year % change)	**-6%**			**-1.4**	**4.0**	**12.1**	**9.2**	**4.5**
Export market share - % of world exports (1 year % change)				-16.1	15.0	10.3	-1.5	-0.3
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**97.2**	**86.7**	**79.3 p**	**75.0**	
Private sector credit flow, consolidated (% of GDP)	**14%**			**1.3**	**3.0**	**6.0 p**	**5.2**	
Household debt, consolidated (% of GDP)		50.3 (6)	18.0 (7)	37.8	34.0	30.7p	29.3	
Non-financial corporate debt, consolidated (% of GDP)		73.0 (6)	38.0 (7)	59.4	52.7	48.6	45.7	
Housing market								
House price index, deflated (1 year % change)	**6%**			**7.1**	**4.9**	**3.2**	**-1.8**	**1.0**
House price index, nominal (1 year % change)		2.2 (8)		7.7	7.3	14.9	5.7	4.0
Government debt								
General government gross debt (% of GDP)	**60%**			**86.8**	**78.1**	**68.2**	**60.8**	**58.8**
General government balance (% of GDP)				-7.3	-2.5	0.1	-0.1	-1.8
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**7.2**	**11.8**	**9.5**	**1.4**	
Return on equity (%)				4.7	7.7	9.4		
Common Equity Tier 1 ratio		10.6 (9)		22.7	23.8	22.1		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				5.3e	4.2e	3.0p	2.9	
Labour market								
Unemployment rate (3 year average)	**10%**			**7.5**	**7.2**	**7.4**	**7.0**	**6.6**
Unemployment rate (year level)		7.2 (10)		7.5	7.6	7.0	6.5	6.2
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.7**	**2.4**	**3.4**	**4.3**	**3.9**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-2.5**	**-0.6**	**0.0**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-6.3**	**-1.8**	**1.4**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

ITALY

In Italy, concerns related to the high government debt remain. The debt-to-GDP ratio has been falling but is expected to broadly stabilise in the future, while the government deficit remains high. The increased average debt maturity has helped cushion the impact of higher interest rates on borrowing costs. Despite improvements in the banking sector, the risk of feedback loops between the government and financial sectors remains.

Real GDP growth reached 3.7% in 2022 and is forecast at 0.7% in 2023 and 0.9% in 2024. Headline inflation stood at 1.9% year-on-year in October 2023. This is below the peak of 12.6% recorded in October 2022 and below the euro area average. Core inflation also decreased, from a peak of 5.5% in February 2023, to 3.9% in October 2023, which is also below the euro area average. Nominal wages per person grew less than prices in 2022 and are expected to also do so in 2023.

The scoreboard reading for Italy shows that three indicators were beyond their indicative thresholds in 2022, namely the export market share, government debt, and the activity rate. From an economic reading of the scoreboard, relevant developments worth highlighting:

- **External sustainability** concerns remain limited. The current account balance worsened from a surplus of 2.4% in 2021 to a deficit of -1.5% in 2022, primarily due to a declining energy balance. However, the current account is expected to return to a surplus in 2023 and broadly stabilise in 2024.

- **Cost competitiveness** concerns remain limited. Nominal unit labour costs rose modestly in 2022 and, though accelerating in 2023, are expected to continue increasing less than the rest of the euro area. Productivity growth exceeded its historical average in 2022, while it is set to fall in 2023. The HICP-based real effective exchange rate depreciated in 2022, but is appreciating marginally in 2023. This reflects in part the fact that the headline inflation rate has been higher in the first half of the year than in the euro area even if core inflation has been lower. Export market shares have been declining.

- The **non-financial corporate debt**-to-GDP ratio decreased to 65% in 2022, close to its 2019 level. The ratio continued to fall in the first half of 2023. Bankruptcies increased recently, albeit from a historically low level.

- At 41% in 2022, the **household debt**-to-GDP ratio remains moderate. After spiking in 2020, the ratio dipped below its pre-pandemic level on the back of high nominal GDP growth. It is set to continue declining in 2023 as inflation remains strong and credit flows have contracted following a rise in interest rates. By mid-2023, 41% of new loans carry variable rates, down from 78% 10 years ago. Non-performing loans have declined but still made up 2.7% of household loans by mid-2023.

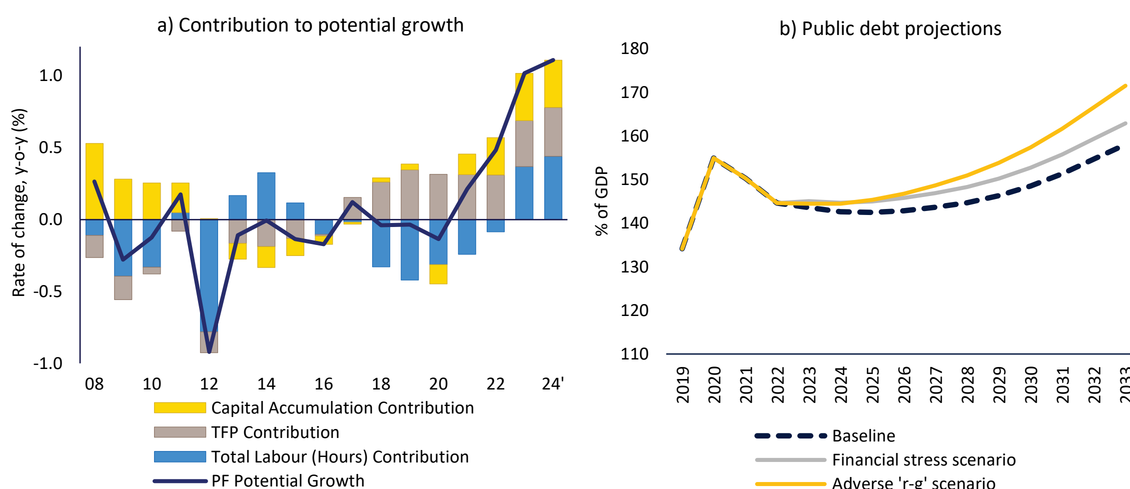
- Improvements have continued in the **banking sector**, but vulnerabilities remain. The non-performing loans ratio declinedto below 3% in 2022 but remains above the euro -area average. Bank profitability improved significantly, driven by an increase in net interest income. The Common Equity Tier 1 capital ratio has declined slightly and remains below the EU average. Bank lending volumes declined significantly as financial conditions tightened from mid-2022. The funding cost of banks is expected to increase with the maturing of the longer-term refinancing operations. The link between the government and financial sectors still represents a

risk of feedback loops. Exposure of the financial sector to commercial real estate at a time of significant correction across the EU requires close monitoring.

- Concerns related to the high **government debt** remain. The debt-to-GDP ratio declined to 141.7% in 2022 and is forecast to fall further in 2023, albeit followed by an increase in 2024 and is expected to remain above the 2019 level. The government deficit remains large, although it is forecast to continue narrowing by 2024. Sovereign bond yields have risen, while the increased average maturity of outstanding debt has helped cushion the increase in borrowing costs. Fiscal sustainability risks are high in the medium term and medium in the long term ([93]).

- **Labour market** weaknesses continue to recede, with employment steadily rising. In 2022, the unemployment rate fell to 8.1% and is forecast to continue falling. The youth unemployment rate dropped to 23.7%, 19 percentage points less than the 2014 peak. The activity rate increased, but remains well below the euro area average, notably for women.

Graph 4.12: **Selected graphs: Italy**



Source: AMECO, Eurostat and European Commission

([93]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.12: **Key economic and financial indicators, Italy**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	forecast 2023	forecast 2024
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**3.2**	**3.2**	**1.6**	**0.6**	**0.1**
Current account balance, balance of payments (% of GDP)		1.6 (1)	0.4 (2)	3.9	2.4	-1.5	0.8	0.9
Net international investment position (% of GDP)	**-35%**	**-67.2 (3)**	**12.1 (4)**	**0.9**	**7.5**	**4.7**	**5.0**	**5.6**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				0.4	5.6	1.6		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**6.5**	**3.5**	**4.9**	**6.0**	**10.9**
Nominal unit labour cost index (% y-o-y change)				3.1	-0.9	2.7	4.2	3.7
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**0.5**	**-1.8**	**-1.9**	**-5.2**	**-6.2**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.8	-0.4	-2.3	0.2	-1.4
Export market share - % of world exports (5 year % change)	**-6%**			**-3.1**	**-6.7**	**-8.4**	**-8.3**	**-7.7**
Export market share - % of world exports (1 year % change)				-2.9	-1.1	-2.5	-0.6	-1.0
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**118.4**	**111.3**	**105.5**	**98.7**	**96.7**
Private sector credit flow, consolidated (% of GDP)	**14%**			**4.0**	**3.3**	**2.9**	**1.3**	**1.4**
Household debt, consolidated (% of GDP)		36.2 (6)	26.3 (7)	44.9	42.5	40.9	38.3	
Non-financial corporate debt, consolidated (% of GDP)		61.3 (6)	28.8 (7)	73.5	68.8	64.6	60.4	
Housing market								
House price index, deflated (1 year % change)	**6%**			**1.8**	**1.0**	**-3.2**	**-2.0**	**-0.5**
House price index, nominal (1 year % change)		-9.3 (8)		1.9	2.6	3.8	3.2	2.0
Government debt								
General government gross debt (% of GDP)	**60%**			**154.9**	**147.1**	**141.7**	**139.8**	**140.6**
General government balance (% of GDP)				-9.6	-8.8	-8.0	-5.3	-4.4
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**7.4**	**8.0**	**-5.7**	**-2.0**	
Return on equity (%)				1.0	5.7	9.1		
Common Equity Tier 1 ratio		10.6 (9)		15.5	15.1	15.2		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				4.5e	3.5e	2.9p	2.8	
Labour market								
Unemployment rate (3 year average)	**10%**			**9.9**	**9.6**	**9.0**	**8.4**	**7.7**
Unemployment rate (year level)		9.2 (10)		9.3	9.5	8.1	7.6	7.4
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**-1.8**	**-1.1**	**-0.2**	**2.4**	**1.5**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-1.8**	**-1.1**	**-1.3**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-4.8**	**-2.5**	**-5.5**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

CYPRUS

In Cyprus, concerns related to household and non-financial corporate debt, government debt, and external debts remain, but are receding overall. The current account continues to record large deficits. Despite visible improvements, non-financial corporate and household debt-to-GDP ratios continue to be high. The banking sector situation improved but vulnerabilities persist, including related to non-performing loans. Government debt has been declining significantly.

Real GDP growth reached 5.1% in 2022 and is forecast to slow down to 2.2% in 2023 and 2.6% in 2024. Headline inflation stood at 3.3% year-on-year in October 2023. This is below the peak of 10.6% recorded in July 2022 but above the euro -area average. Core inflation also decreased, from a peak of 7.2% in August 2022 to 2.8% in October 2023, which is below the euro area average. Nominal wages per person grew less than prices in 2022 but are growing more than prices in 2023.

The scoreboard reading for Cyprus shows that five indicators were beyond their indicative thresholds in 2022, namely the current account balance, net international investment position, private sector debt, government debt, and the youth unemployment rate. Relevant developments worth highlighting:

- **External sustainability** remains a concern. The current account deficit widened from 6.1% in 2021 to 7.9% in 2022, far exceeding the deficits recorded before the COVID-19 pandemic. Energy and non-energy goods balances were key contributors. The current account balance deteriorated markedly in the first quarter of 2023 mostly due to a large transfer of economic ownership of transport equipment, mainly ships. The current account is therefore expected to deteriorate to almost -10% of GDP in 2023 before improving to -8.8% in 2024, considerably below levels explained by fundamentals. The net international investment position (NIIP) improved from -104% in 2021 to -96.2% of GDP in 2022 owing to strong nominal growth, and is expected to remain stable in 2023 and 2024. Although the NIIP remains very negative, it largely reflects the activities of special purpose entities. The NIIP net of non-defaultable instruments improved markedly and came close to balance, reducing concerns related to the external position.

- **Cost competitiveness** concerns are limited. Nominal unit labour costs marginally fell in 2022, against a backdrop of marked expansion of output per worker and moderate nominal wage growth. In 2023, unit labour costs are expected to grow fast, but below the euro -area average. The HICP-based real effective exchange rate depreciated visibly in 2022, but is appreciating in 2023 due to appreciation in the nominal exchange rate, while inflation has been below the euro -area average.

- The **non-financial corporate debt**-to-GDP ratio remains among the highest in the EU, but is on a declining path and well below its 2019 level. It reached 142% in 2022 and continued falling in the first half of 2023. The high share of foreign debt of non-financial ship-owning special purpose entities and high liquidity buffers mitigate risks. The corporate non-performing loans ratio decreased further in 2022, but some risks remain as non-performing loans have been transferred out of the banking system but are held by credit acquiring companies.

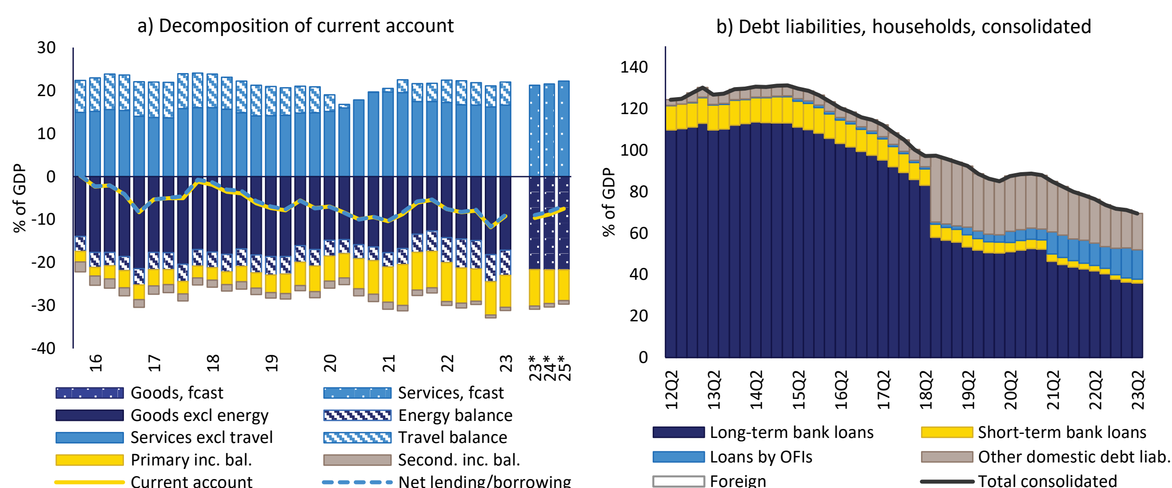
- The **household debt-**to-GDP ratio fell to 72% in 2022 and is set to fall further in 2023, but remains high. Net credit flows turned negative in the face of rising interest rates. By mid-2023, almost 70% of new loans carried variable interest rates, down from more than 90% a year earlier. 2021 Household Finance Consumption Survey data suggest a high median debt service-to-income ratio compared with other EU countries, especially for debtors in the bottom 40% of

the income distribution, which make up around 11% of all households. Households' aggregate gross savings rate decreased in 2022 amid a strong contraction of real compensation. On the upside, real wages are forecasted to grow in 2023-2024, supporting household balance sheets. Non-performing loans have been declining but remain very high, at 11% of all household loans by mid-2023.

- The **banking sector** situation has improved but vulnerabilities persist. The non-performing loans and Stage 2 loans ratios further declined in 2022, reaching 4.3% in the first quarter of 2023 but remaining above the EU average. However, the non-performing loans coverage ratio has increased and now exceeds the EU average. While the Common Equity Tier 1 capital ratio is close to the EU average, return on equity is still well below it despite some improvement in 2022 amid higher interest rate income. The increase in lending rates also represents risk in the face of high private sector indebtedness, but the overall quality of the loan portfolios has remained broadly stable. Credit provision remained very muted in 2022 and in the first half of 2023.

- Concerns related to the **government debt**-to-GDP ratio remain but are receding. The government debt ratio decreased by nearly 14 percentage points to 85.6% of GDP in 2022, which is below the 2019 level and is forecast to decrease further to 66.3% in 2025. Sovereign bond spreads tend to be higher than in other euro area countries. The fiscal balance turned into a surplus in 2022 and is projected to remain positive. Primary surpluses are expected to keep government gross financing needs at relatively low levels. Furthermore, Cyprus has sizeable cash buffers. The fiscal sustainability risks are medium in the medium-term ([94]).

Graph 4.13: **Selected graphs: Cyprus**



Source: AMECO, Eurostat and European Commission

([94]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.13: **Key economic and financial indicators, Cyprus**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	*2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**-6.5**	**-7.2**	**-8.0**	**-7.9**	**-8.8**
Current account balance, balance of payments (% of GDP)		-1.8 (1)	-0.9 (2)	-10.0	-6.1	-7.9	-9.7	-8.8
Net international investment position (% of GDP)	**-35%**	**-62.1 (3)**	**-39.1 (4)**	**-133.4**	**-104.0**	**-96.2**	**-96.7**	**-98.2**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-110.4	-2.2	39.9		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**5.8**	**2.4 p**	**-1.2 p**	**1.4**	**6.6**
Nominal unit labour cost index (% y-o-y change)				1.8	-2.1 p	-0.9 p	4.5	3.0
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**-0.4**	**-2.4**	**-3.0**	**-0.6**	**-1.3**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.3	-0.2	-3.1	2.2	-0.9
Export market share - % of world exports (5 year % change)	**-6%**			**38.5**	**32.5**	**20.7**	**14.6**	**8.4**
Export market share - % of world exports (1 year % change)				13.5	3.5	-5.5	-1.8	-0.5
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**267.2**	**242.1**	**213.4 p**	**195.0**	**173.9**
Private sector credit flow, consolidated (% of GDP)	**14%**			**-1.4**	**6.5**	**-3.9 p**	**-5.7**	**-10.0**
Household debt, consolidated (% of GDP)		40.7 (6)	91.1 (7)	88.6	79.9	71.7p	64.4	
Non-financial corporate debt, consolidated (% of GDP)		64.3 (6)	132.0 (7)	178.6	162.2	141.7	130.6	
Housing market								
House price index, deflated (1 year % change)	**6%**			**0.8**	**-4.2**	**-3.1**	**-1.2**	**-3.0**
House price index, nominal (1 year % change)		-14.0 (8)		-0.2	-3.4	3.2	2.9	0.0
Government debt								
General government gross debt (% of GDP)	**60%**			**114.9**	**99.3**	**85.6**	**78.4**	**71.5**
General government balance (% of GDP)				-5.7	-1.9	2.4	2.3	2.1
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**-7.0**	**3.6**	**-2.3**	**0.1**	
Return on equity (%)				-3.3	0.6	5.1		
Common Equity Tier 1 ratio		10.6 (9)		17.6	17.6	17.8		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				11.0e	5.6e	4.5p	4.2	
Labour market								
Unemployment rate (3 year average)	**10%**			**7.7**	**7.4**	**7.3**	**6.9**	**6.4**
Unemployment rate (year level)		8.0 (10)		7.6	7.5	6.8	6.4	6.1
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**1.9**	**1.7**	**2.2**	**2.1**	**1.4**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-2.4**	**-0.1**	**0.2**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-6.5**	**-3.1**	**2.0**		

Notes: See Annex 1
Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

LATVIA

In Latvia, cost competitiveness pressures persist and house price growth remains elevated, although associated macroeconomic risks appear to be limited. Nominal unit labour costs are set to continue increasing, driven by weakening productivity growth. Core inflation has started to decrease but remains above the euro area overall. Nominal house price growth has moderated recently, but house prices still show signs of overvaluation.

Real GDP growth reached 3.4% in 2022 and is forecast at -0.2% in 2023 and 2.4% in 2024. Headline inflation stood at 2.4% year-on-year in October 2023. This is below the peak of 22% recorded in September 2022 and below the euro area average. Core inflation also decreased, from a peak of 11.1% in February 2023 to 7.2% in September 2023, which is above the euro area average. Nominal wages per person grew less than prices in 2022 but are expected to grow more than prices in 2023.

The scoreboard reading for Latvia shows that four indicators were beyond their indicative thresholds in 2022, namely the real effective exchange rate, unit labour costs, the activity rate, and the youth unemployment rate. Relevant developments worth highlighting:

- **External sustainability** concerns are limited but warrant close monitoring, as the current account deficit is expected to remain sizeable. It increased from 3.9% of GDP in 2021 to 4.7% in 2022 but is expected to narrow to 4.2% in 2023 and to 3.2% in 2024, supported by improvements in the goods balance and the capital account. The net international investment position (NIIP) remained broadly stable at -27% of GDP in 2022. Since Latvia's liabilities largely consist of government bonds and foreign direct investment, the NIIP excluding non-defaultable instruments is positive.

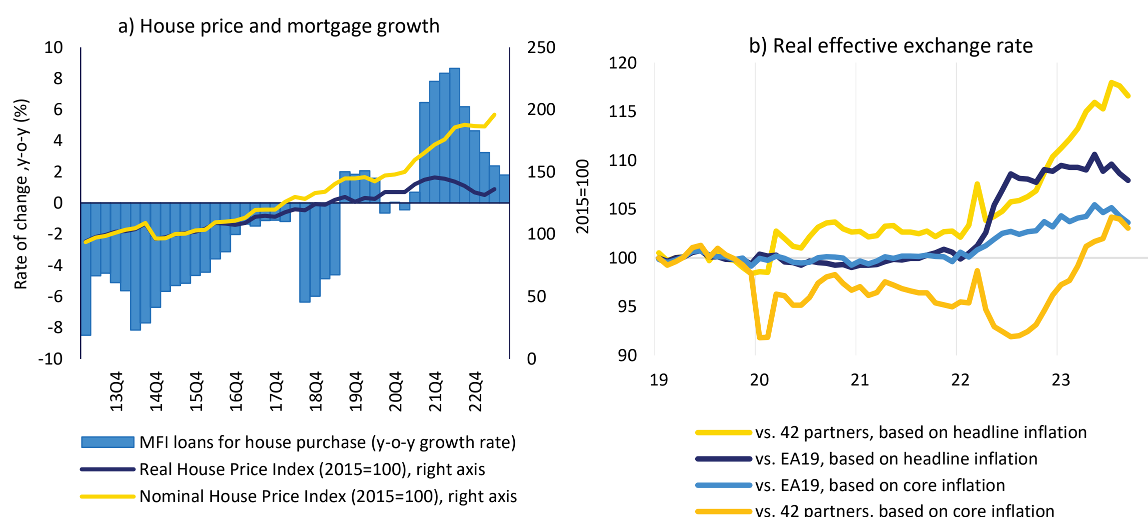
- **Cost competitiveness** concerns persist and are widening. Nominal unit labour costs have been increasing rapidly for several years and grew particularly sharply in 2022 amid substantial nominal wage increases and low labour productivity. In 2023, unit labour costs are expected to continue growing at a similarly high rate, driven by high wage increases amid labour shortages, well above the rest of the euro area. For 2024, they are projected to slow down significantly. The HICP-based real effective exchange rate appreciated markedly in 2022 with higher inflation at home. Appreciation has continued in 2023.

- The **non-financial corporate debt** and **household debt**-to-GDP ratios are low and declined further in 2022. The non-financial corporate debt ratio remained broadly unchanged in the first half of 2023, while household debt continued to edge down.

- **House price** growth accelerated to 13.8% in 2022 but appears to have moderated in recent quarters. As a result of recent increases, house prices are estimated to be overvalued by 12%.

- The **banking sector** is sound and well capitalised. The Common Equity Tier 1 capital ratio declined in 2022 but remains the highest in the EU. Profitability improved in 2022 and is close to the EU average. The non-performing loans ratio declined slightly to 1.3% (as of first quarter of 2023) and the Stage 2 loans ratio also fell. Credit dynamics have been rather muted.

Graph 4.14: **Selected graphs: Latvia**



Source: AMECO, Eurostat and European Commission

Table 4.14: **Key economic and financial indicators, Latvia**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	*2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**0.7**	**-0.5**	**-1.9**	**-4.3**	**-4.0**
Current account balance, balance of payments (% of GDP)		-0.5 (1)	-3.1 (2)	2.9	-3.9	-4.7	-4.2	-3.2
Net international investment position (% of GDP)	**-35%**	**-52.1 (3)**	**-13.2 (4)**	**-34.0**	**-27.3**	**-26.5**	**-24.4**	**-22.6**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				14.5	19.4	16.9		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**19.2**	**12.0**	**16.7**	**22.9**	**30.2**
Nominal unit labour cost index (% y-o-y change)				5.6	-0.9	11.6	11.2	4.9
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**5.9**	**2.3**	**5.7**	**7.1**	**7.2**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				2.0	0.3	3.3	2.5	0.5
Export market share - % of world exports (5 year % change)	**-6%**			**20.3**	**13.1**	**15.3**	**7.3**	**6.9**
Export market share - % of world exports (1 year % change)				12.5	-2.6	3.6	-4.2	-1.8
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**65.2**	**58.5**	**52.5**	**50.7**	**48.6**
Private sector credit flow, consolidated (% of GDP)	**14%**			**-1.8**	**0.9**	**3.0**	**1.6**	**1.3**
Household debt, consolidated (% of GDP)		50.3 (6)	18.2 (7)	20.4	19.5	17.7	16.9	
Non-financial corporate debt, consolidated (% of GDP)		73.4 (6)	67.9 (7)	44.8	39.0	34.8	33.8	
Housing market								
House price index, deflated (1 year % change)	**6%**			**3.5**	**7.2**	**-1.0**	**-4.5**	**-1.2**
House price index, nominal (1 year % change)		11.7 (8)		3.5	10.9	13.8	4.6	2.0
Government debt								
General government gross debt (% of GDP)	**60%**			**42.2**	**44.0**	**41.0**	**41.7**	**42.3**
General government balance (% of GDP)				-4.5	-7.2	-4.6	-3.2	-3.1
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**10.6**	**13.3**	**4.1**	**-0.1**	
Return on equity (%)				5.2	4.5	10.2		
Common Equity Tier 1 ratio		10.6 (9)		25.7	29.2	23.6		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				4.6e	2.1e	1.4p	1.2	
Labour market								
Unemployment rate (3 year average)	**10%**			**7.3**	**7.3**	**7.5**	**7.1**	**6.8**
Unemployment rate (year level)		6.5 (10)		8.1	7.6	6.9	6.8	6.6
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**1.1**	**-1.8**	**-0.5**	**-1.3**	**1.1**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-1.2**	**-1.1**	**-0.7**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-2.1**	**2.6**	**2.6**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

LITHUANIA

In Lithuania, cost competitiveness pressures persist and house price growth remains high, although associated macroeconomic risks appear to be limited. Nominal unit labour cost growth remains high. Core inflation started to decrease but remains well above the euro area overall. Nominal house price growth moderated in recent quarters but remains high.

Real GDP growth reached 2.4% in 2022 and is forecast at -0.4% in 2023 and 2.5% in 2024. Headline inflation stood at 3% year-on-year in October 2023. This is below the peak of 22.5% recorded in September 2022 but slightly above the euro area average. Core inflation also decreased, from a peak of 12.7% in November 2022 to 8.2% in September 2023, which is also above the euro area average. Nominal wages per person grew less than prices in 2022 but are expected to grow faster than prices in 2023.

The scoreboard reading for Lithuania shows that two indicators were beyond their indicative thresholds in 2022, namely the real effective exchange rate and unit labour costs. Relevant developments worth highlighting:

- **External sustainability** concerns remain contained. In 2022, the current account underwent the largest deterioration in the EU, shifting from a 1.1% surplus to a deficit of 5.5%, primarily driven by a much wider energy goods deficit. There was a noticeable rebound to 2.4% in the second quarter of 2023 due to an increase in the primary income and energy balances. The current account balance is forecast to return to a small surplus in 2023. The net international investment position (NIIP) remained slightly negative in 2022, at -7% of GDP, and is expected to remain broadly stable over the forecast period. As liabilities largely consist of foreign direct investment, the NIIP net of non-defaultable instruments is positive.

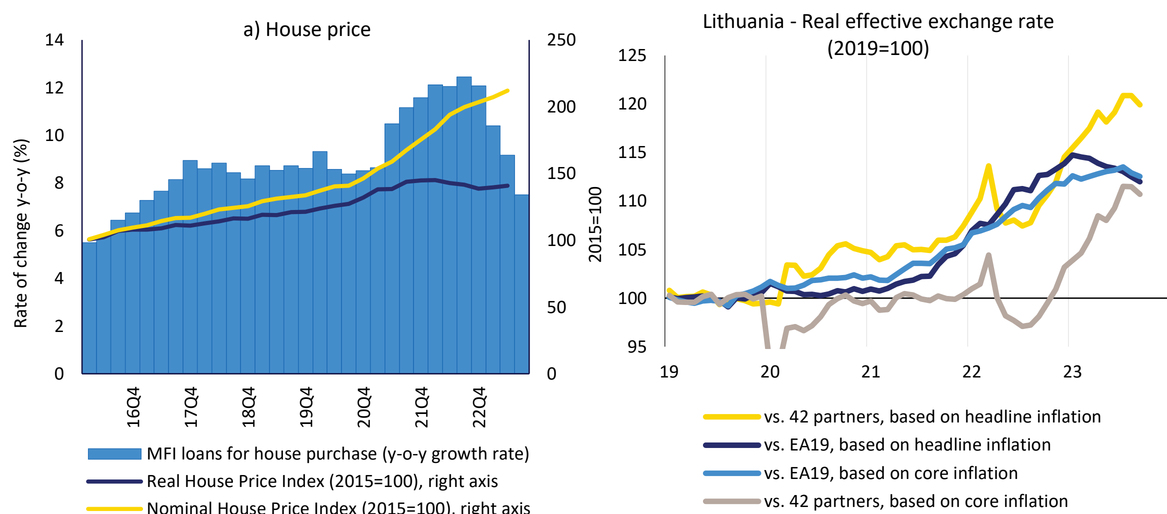
- **Cost competitiveness** concerns persist and are widening. After several years of significant increases, nominal unit labour costs increased sharply in 2022 on account of significant nominal wage increases, labour shortages, and falling output per worker amid large increases in employment. In 2023, unit labour costs are expected to grow less than before, but still strongly and visibly more than in the euro area on account of large nominal wage increases and much more limited productivity gains amid weak activity. The HICP-based real effective exchange rate appreciated markedly in 2022, including when measured based on core inflation, on account of much higher inflation at home relative to most relevant trading partners. Appreciation has continued in 2023.

- The **non-financial corporate** and **household debt**-to-GDP ratios are low and declined further in 2022. Both ratios remained relatively stable in the first half of 2023.

- **House price** growth remains a concern, despite some moderation. It accelerated to 19% in 2022. Over recent quarters, house price growth has moderated but remains high. Despite strong growth in recent years, house prices are estimated to be valued in line with fundamentals as over the medium term, strong house price growth was nearly matched by income growth.

- The **banking sector** is sound and well capitalised. While the Common Equity Tier 1 capital ratio declined in 2022, it remains one of the highest in the EU. Profitability improved in 2022, with return on equity at 13.5%, and is above the EU average. The non-performing loans ratio and the Stage 2 loans ratio are slightly below 1% (as of first quarter of 2023). Credit provision remains dynamic, although it has declined.

Graph 4.15: **Selected graphs: Lithuania**



Source: AMECO, Eurostat and European Commission

Table 4.15: **Key economic and financial indicators, Lithuania**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	forecast *2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**3.7**	**4.0**	**1.0**	**-1.4**	**-1.7**
Current account balance, balance of payments (% of GDP)		0.3 (1)	-1.5 (2)	7.3	1.1	-5.5	0.3	0.1
Net international investment position (% of GDP)	**-35%**	**-61.8 (3)**	**1.1 (4)**	**-15.7**	**-7.4**	**-7.0**	**-6.7**	**-6.1**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				15.1	22.1	21.2		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**17.3**	**18.7**	**27.7**	**36.4**	**34.7**
Nominal unit labour cost index (% y-o-y change)				5.0	6.5	14.2	12.1	5.2
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**6.7**	**4.4**	**9.8**	**13.4**	**10.1**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				3.2	1.9	4.5	3.8	-1.1
Export market share - % of world exports (5 year % change)	**-6%**			**38.3**	**36.6**	**28.8**	**16.0**	**8.9**
Export market share - % of world exports (1 year % change)				8.8	2.7	3.2	-5.4	-0.1
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**54.3**	**53.6**	**51.4**	**50.3**	**50.9**
Private sector credit flow, consolidated (% of GDP)	**14%**			**0.3**	**5.8**	**6.8**	**4.3**	**3.3**
Household debt, consolidated (% of GDP)		52.1 (6)	15.8 (7)	24.1	23.4	21.8	21.2	
Non-financial corporate debt, consolidated (% of GDP)		70.9 (6)	48.8 (7)	30.2	30.2	29.6	29.1	
Housing market								
House price index, deflated (1 year % change)	**6%**			**6.0**	**10.9**	**0.4**	**-2.8**	**1.1**
House price index, nominal (1 year % change)		-1.8 (8)		7.3	16.1	19.0	6.4	4.0
Government debt								
General government gross debt (% of GDP)	**60%**			**46.2**	**43.4**	**38.1**	**37.3**	**38.3**
General government balance (% of GDP)				-6.5	-1.1	-0.7	-1.6	-2.3
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**32.6**	**22.6**	**1.0**	**1.4**	
Return on equity (%)				10.0	10.4	13.5		
Common Equity Tier 1 ratio		10.6 (9)		21.5	23.2	20.2		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				2.2e	1.2e	0.9p	1.0	
Labour market								
Unemployment rate (3 year average)	**10%**			**7.0**	**7.3**	**7.2**	**6.6**	**6.5**
Unemployment rate (year level)		6.0 (10)		8.5	7.1	6.0	6.8	6.7
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**2.6**	**0.9**	**0.6**	**-0.1**	**0.6**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.2**	**0.6**	**0.4**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**6.3**	**3.2**	**0.0**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

LUXEMBOURG

In Luxembourg, house prices and household debt remain high, although associated macroeconomic risks appear to be limited. Nominal house prices decreased in recent quarters but prices are still estimated to be overvalued in the faceof a high but declining household debt-to-GDP ratio. The banking sector is resilient but faces some risks. Nominal unit labour costs have increased markedly and are expected to continue growing strongly again this year.

Real GDP growth reached 1.4% in 2022 and is forecast at -0.6% in 2023 and 1.4% in 2024. Headline inflation stood at 2.1% year-on-year in October 2023. This is below the peak of 10.3% recorded in June 2022 and below the euro area average. Core inflation also decreased, from a peak of 5.1% in August 2022 to 3.8% in September 2023, which is also below the euro area average. Nominal wages per person grew less than prices in 2022 and are expected to grow broadly in line with prices in 2023.

The scoreboard reading for Luxembourg shows that three indicators were beyond their indicative thresholds in 2022, namely the current account balance, unit labour costs and private sector debt. Relevant developments worth highlighting:

- **Cost competitiveness** concerns have increased recently. Nominal unit labour costs increased markedly in 2022 and are expected to grow as strongly again in 2023. This denotes higher growth than in the rest of the euro area on account of nominal wage increases amid the widespread indexation of wages to past inflation and compounded by receding average productivity per worker. Despite this, inflation has been lower than in the rest of the euro area, mainly due to measures to cap gas prices and freeze electricity prices until the end of 2024. Core inflation has also been below the euro area average. As a result, the HICP and core inflation-based real effective exchange rate depreciated in 2022. The real effective exchange rate is expected to be largely muted in 2023. **External sustainability** concerns remain limited, amid gradually declining current account surpluses expected over the forecast period.

- The **non-financial corporate debt**-to-GDP ratio is the highest in the EU, although it declined to 259% in 2022 and continued decreasing in the first two quarters of 2023. Nonetheless, it remains some 27 percentage points higher than in 2019. Credit flows to non-financial corporates declined substantially in 2022 and contributed to the reduction in debt that was also facilitated by high nominal GDP growth. At 11%, the share of domestic corporate loans denominated in foreign currency is one of the highest among euro area countries. The high share of cross-border intra-group lending in corporate debt reduces risks.

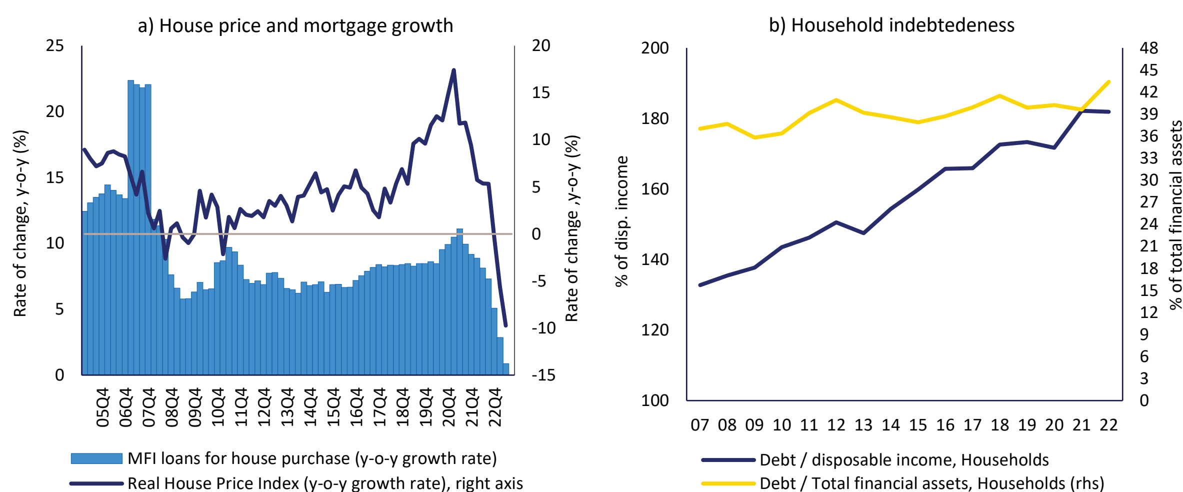
- Following a long-term upward trend, the **household debt**-to-GDP ratio is high, at 67% in 2022, and is expected to remain high in 2023. When expressed as a share of household gross disposable income, household debt is among the highest in the EU, at almost 180% in 2022. Net credit flows have contracted in response to a tripling of borrowing costs, but remain incentivised by increasing fiscal support. Risk factors include a still high share of variable rate mortgages, a high median debt service-to-income ratio (16%), reaching 35% for debt holders in the bottom quintile of the income distribution, which make up 9% of all households, and a high price-to-income ratio. On the upside, the gross savings rate is high, and 2023 and 2024 are expected to bring robust real wage growth.

- Concerns related to the **housing market** persist, and house prices have turned negative in recent quarters. Mortgage lending and the number of transactions have fallen significantly. House price growth decelerated to just under 10% in 2022, building on years of strong growth,

which has resulted in house prices being estimated to be overvalued by over 60%. A very strong decline in house prices is unlikely in the medium term as demand is supported by high population growth, the large number of cross-border workers, tax measures and structurally low housing supply. However, some continued short-term reductions can be expected as house prices adjust to higher interest rates in 2023 and 2024.

- The **banking sector** is well capitalised, but profitability remained below the EU average in 2022. The ratio of non-performing loans has been very low despite a mild increase in 2022. Credit dynamics have declined significantly amid the tightening of financing conditions. High household indebtedness, coupled with overvalued house prices, represents the main risk for the domestically oriented banking sector. The financial sector is significantly exposed to the commercial real estate sector, although mainly via investment funds without a direct link to domestic real estate. An ongoing correction of commercial real estate prices therefore represents a limited risk for the financial sector. **Government debt** remains very low despite recent increases.

Graph 4.16: **Selected graphs: Luxembourg**



Source: AMECO, Eurostat and European Commission

Table 4.16: **Key economic and financial indicators, Luxembourg**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	forecast *2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**8.0**	**8.5**	**8.0**	**7.2**	**6.2**
Current account balance, balance of payments (% of GDP)		5.3 (1)	2.2 (2)	8.6	7.9	7.7	5.9	5.0
Net international investment position (% of GDP)	**-35%**	**-167.6 (3)**	**55.9 (4)**	**42.4**	**42.6**	**47.0**	**52.8**	**58.6**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-4063.1	-4598.7	-3753.7		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**12.4**	**7.4**	**13.2**	**17.9**	**21.5**
Nominal unit labour cost index (% y-o-y change)				3.9	0.9	7.9	8.3	4.0
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**1.5**	**0.7**	**-0.5**	**-0.3**	**-1.0**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.4	0.8	-1.7	-0.1	0.1
Export market share - % of world exports (5 year % change)	**-6%**			**21.7**	**16.7**	**-0.8**	**-1.8**	**-8.0**
Export market share - % of world exports (1 year % change)				15.8	-1.6	-16.6	-2.4	-0.8
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**327.8**	**343.9**	**325.5 p**	**312.2**	**308.1**
Private sector credit flow, consolidated (% of GDP)	**14%**			**45.7**	**64.1**	**-19.5 p**	**6.9**	**11.3**
Household debt, consolidated (% of GDP)		99.4 (6)	79.3 (7)	68.8	66.6	66.8	66.7	
Non-financial corporate debt, consolidated (% of GDP)		123.2 (6)	86.3 (7)	259.0	277.3	258.7	245.5	
Housing market								
House price index, deflated (1 year % change)	**6%**			**12.7**	**12.5**	**4.0**	**2.1**	**0.9**
House price index, nominal (1 year % change)		62.7 (8)		14.5	13.9	9.6	5.8	4.0
Government debt								
General government gross debt (% of GDP)	**60%**			**24.6**	**24.5**	**24.7**	**26.8**	**28.7**
General government balance (% of GDP)				-3.4	0.6	-0.3	-1.9	-2.1
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**-2.2**	**13.1**	**-4.9**	**0.4**	
Return on equity (%)				4.4	5.5	5.2		
Common Equity Tier 1 ratio		10.6 (9)		19.5	18.3	17.6		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				0.7e	0.6e	1.2p	0.8	
Labour market								
Unemployment rate (3 year average)	**10%**			**6.0**	**5.9**	**5.6**	**5.1**	**5.3**
Unemployment rate (year level)		5.8 (10)		6.8	5.3	4.6	5.5	5.9
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**2.0**	**2.1**	**1.5**	**1.5**	**0.6**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.4**	**0.4**	**0.0**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**7.8**	**2.7**	**0.6**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

HUNGARY

In Hungary, concerns related to strong price and cost pressures, government and external financing needs, and house prices remain. Nominal unit labour costs are forecast to continue increasing at high rates and core inflation remains well above the euro area average, albeit it is declining fast. The very large current account deficit has narrowed markedly in the course of 2023; the government deficit remains very high.

Real GDP growth reached 4.6% in 2022 and is forecast at -0.7% in 2023 and 2.4% in 2024. Headline inflation remained high, at 12.2% year-on-year in September 2023. This is below the peak of 26.2% recorded in January 2023 but above the EU and euro area averages. Core inflation also decreased, from a peak of 17.4% in March 2023, to 12% in September 2023, which is also above the EU and euro area averages. Nominal wages per person grew more than prices in 2022 and are expected to grow less than prices in 2023.

The scoreboard reading for Hungary shows that four indicators were beyond their indicative thresholds in 2022, namely the current account balance, net international investment position, unit labour costs, and government debt. Relevant developments worth highlighting:

- Concerns about **external sustainability** persist, despite an improvement in the current account driven by the cyclical downturn on the top of falling energy prices. The current account balance, which recorded a surplus in the years before the pandemic, deteriorated to a deficit of 8.3% of GDP in 2022. In the second quarter of 2023, the current account balance improved to -5.4%, as domestic demand softened. It is projected to turn positive this year before falling slightly in 2024. The negative net international investment position (NIIP) improved sligthly to -50.8% in 2022 and is expected to remain broadly unchanged this year and next. The NIIP net of non-defaultable instruments is around balance. In September 2023, Hungary's foreign reserves exceeded short-term external debt, but they covered less than 3 months of imports in 2022.

- **Cost competitiveness** concerns persist and are widening. After several years of marked increases, nominal unit labour costs have continued to grow sharply in 2022 and 2023 on account of significant nominal wage growth. Their expected growth in 2023 is much faster than in trading partners. However, a slowdown in unit labour cost growth is projected for 2024. The HICP-based real effective exchange rate depreciated in 2022, as a significant nominal depreciation more than offset the clearly higher inflation at home relative to trading partners. However, a strong appreciation is underway in 2023, driven by both nominal appreciation and persistently higher inflation. Core inflation has declined in recent months but remains in double-digit territory.

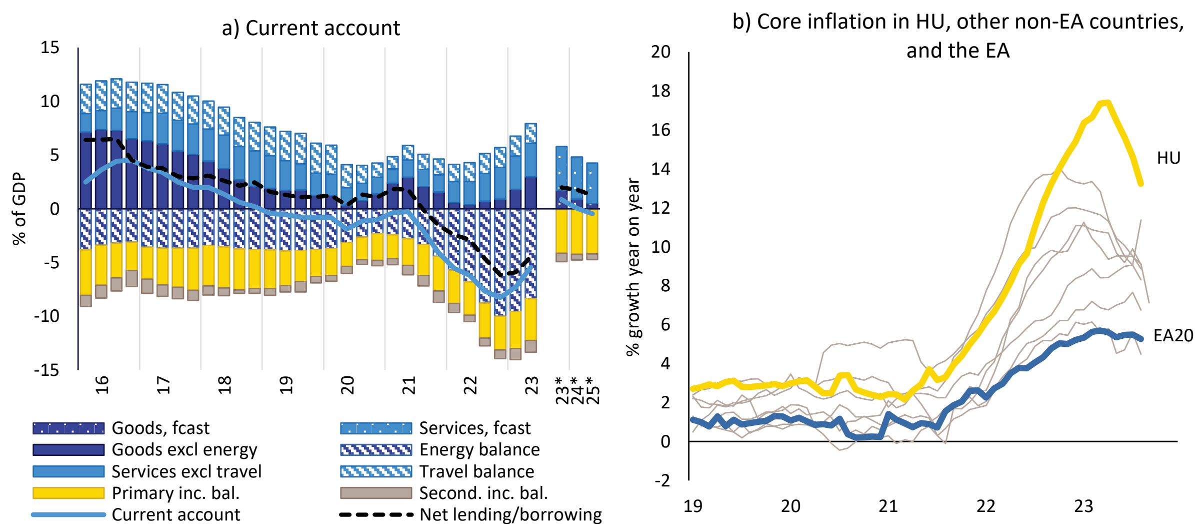
- The **non-financial corporate debt**-to-GDP ratio is high compared to regional peers and it remained unchanged in 2022, at 60%, 11 percentage points above its 2019 level. Credit flows to non-financial corporates remained high, at 8.2% of GDP in 2022, but decreased at the end of 2022 and in the first half of 2023. The corporate debt-to-GDP ratio decreased in the first two quarters of 2023. Over 2022 and 2023, the interest rate burden has been increasing more than in most other EU countries though. The share of domestic corporate loans denominated in foreign currency is very high, at 40%, and is increasing. Part of this high share may be accounted for by borrowers in non-tradable sectors and therefore with less revenue in foreign currencies. Corporate borrowing in euro has expanded recently. Bankruptcies increased sharply in recent quarters, partly following the 2021 update of the insolvency law.

- **House price** growth accelerated to nearly 22% in 2022, coming on top of many years of strong growth that has led to an estimated overvaluation of house prices by nearly 20%. Since the end of 2022, a moderation in house prices is evident, as house prices adjust to higher interest rates and demand is tempered by the sharp slowdown in the economy. The household debt-to-GDP ratio remains low, and credit flows have decreased, but non-performing loans remain relatively high at almost 5% of all loans to households by mid-2022.

- The **banking sector** remains sound overall, but some vulnerabilities remain. Profitability declined in 2022 and is close to the EU average, as is the Common Equity Tier 1 capital ratio. While the non-performing loans ratio has been gradually declining (2.8% in the first quarter of 2023), the Stage 2 loans ratio has increased significantly since 2020. Government debt accounts for almost a fifth of bank assets. Lending rates have increased sharply, dampening mortgage credit growth. Government policies, including specific taxes on the banking sector and caps on certain lending rates, have a significant impact on profitability.

- Public finances continue to be under pressure. **The government debt**-to-GDP ratio decreased slightly, to 73.9% in 2022 as strong nominal GDP growth affected the denominator despite a sizeable government deficit. Debt is forecast to fall to around 70% in 2023, before rising again in 2024 due to a high deficit and lower nominal GDP growth. The government deficit narrowed to 6.2% of GDP in 2022 and is forecast to recede to 5.8% of GDP in 2023 and somewhat further in 2024. A significant share of government debt is denominated in foreign currencies or held by non-residents. Sovereign bond yields have been elevated and government gross financing needs are high. Fiscal sustainability risks are high in the medium and long term ([95]).

Graph 4.17: **Selected graphs: Hungary**



Source: AMECO, Eurostat and European Commission

([95]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.17: **Key economic and financial indicators, Hungary**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	*2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**-0.6**	**-2.0**	**-4.5**	**-3.8**	**-2.5**
Current account balance, balance of payments (% of GDP)		0.0 (1)	-4.6 (2)	-1.0	-4.1	-8.3	0.8	0.0
Net international investment position (% of GDP)	**-35%**	**-53.7 (3)**	**-15.5 (4)**	**-52.1**	**-52.2**	**-50.8**	**-49.7**	**-48.2**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-2.5	-1.2	-5.3		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**13.7**	**13.3**	**23.1 p**	**32.6**	**38.9**
Nominal unit labour cost index (% y-o-y change)				6.7	2.9	12.1 p	14.9	7.8
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**-4.9**	**-4.1**	**-8.1**	**8.4**	**7.2**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				-3.7	0.3	-4.9	10.4	-0.8
Export market share - % of world exports (5 year % change)	**-6%**			**7.1**	**-2.7**	**-3.5**	**-3.8**	**-4.6**
Export market share - % of world exports (1 year % change)				2.5	-6.1	-0.4	-0.6	0.1
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**77.0**	**80.9**	**78.8 p**	**68.6**	**67.7**
Private sector credit flow, consolidated (% of GDP)	**14%**			**8.2**	**12.9**	**9.2 p**	**5.3**	**3.7**
Household debt, consolidated (% of GDP)		37.8 (6)	30.6 (7)	20.8	21.1	18.6p	16.5	
Non-financial corporate debt, consolidated (% of GDP)		54.3 (6)	44.2 (7)	56.2	59.8	60.2	52.1	
Housing market								
House price index, deflated (1 year % change)	**6%**			**1.5**	**9.6**	**5.1 p**	**-9.9**	**-2.1**
House price index, nominal (1 year % change)		23.0 (8)		4.9	16.5	22.3p	5.6	3.0
Government debt								
General government gross debt (% of GDP)	**60%**			**79.3**	**76.7**	**73.9**	**69.9**	**71.7**
General government balance (% of GDP)				-7.6	-7.2	-6.2	-5.8	-4.3
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**55.0**	**16.5**	**8.6**	**0.0**	
Return on equity (%)				7.6	12.7	11.9		
Common Equity Tier 1 ratio		10.6 (9)		15.9	17.7	16.2		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				3.6e	3.2e	3.1p	2.7	
Labour market								
Unemployment rate (3 year average)	**10%**			**3.7**	**3.8**	**3.9**	**3.9**	**4.0**
Unemployment rate (year level)		3.2 (10)		4.1	4.1	3.6	4.1	4.2
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**2.0**	**2.1**	**2.5**	**3.6**	**2.9**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.5**	**-0.1**	**0.1**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**2.0**	**3.6**	**-0.6**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

MALTA

In Malta, the current account balance remains negative and non-financial corporate and government debt elevated, although associated risks appear to be limited. The high non-financial corporate debt-to-GDP ratio remains on a declining path. The government debt-to-GDP ratio is forecast to increase amidst a high government deficit.

Real GDP growth reached 6.9% in 2022 and is forecast at 4% in 2023 and 4% in 2024. Headline inflation stood at 4.3% year-on-year in October 2023. This is below the peak of 7.4% recorded in September 2022 but above the euro area average. Core inflation also decreased, from a peak of 7.2% in September 2022 to 3.8% in October 2023, which is below the euro area average. Nominal wages per person grew less than prices in 2022 and are expected to also do so in 2023.

The scoreboard reading for Malta shows that no indicator was beyond its indicative threshold in 2022. Relevant developments worth highlighting:

- **External sustainability** concerns remain limited. The current account balance fell from 1.2% in 2021 to -3.0% in 2022 and remained in a slight deficit in the first half of 2023. The balance of trade in goods has been a key driver of the current account changes. The current account balance is expected to increase to almost 2% in 2023 and increase further in 2024. The net international investment position remains large and positive, reflecting the country's position as an international financial centre. Cost competitiveness concerns seem to be limited.

- The **non-financial corporate debt**-to-GDP ratio remains high, although it is on a declining path. It reached 66% in 2022, 8 percentage points lower than in 2019, and continued decreasing in the first half of 2023.

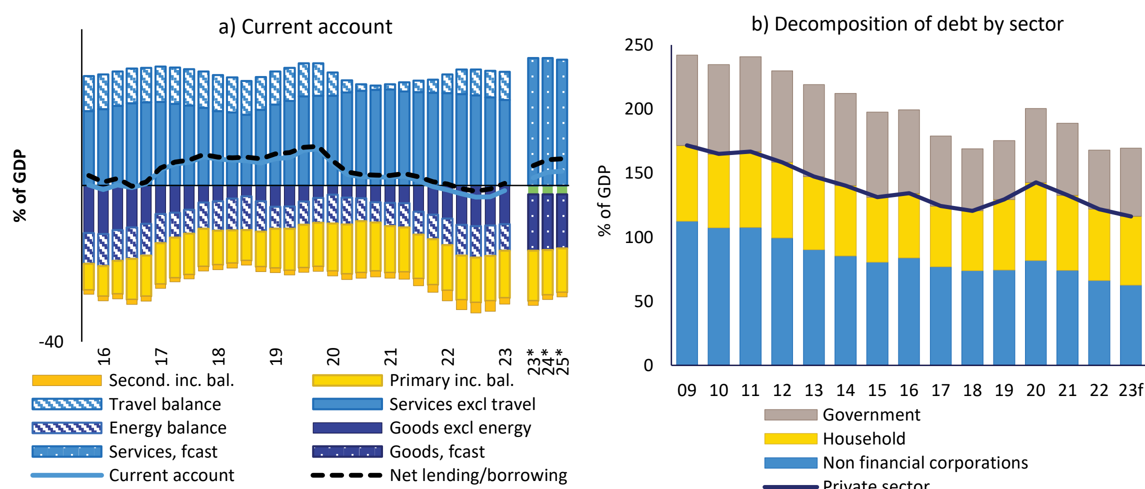
- At 56% in 2022, the **household debt**-to-GDP ratio remains moderately high. It is set to decrease in 2023. Credit flows are among the largest in the EU and are easing only slowly in the face of relatively stable interest rates. Almost 70% of new mortgages had a variable rate (<1 year fixation period) in mid-2023, down from 93% a decade ago. House price growth accelerated slightly in 2022 overall, but a moderation is evident in recent quarters.

- The **banking sector** remains sound overall with high levels of capitalisation, but with some risks. The non-performing loans ratio, at 2.4% (as of first quarter of 2023), has been slightly above the EU average. The Stage 2 loans ratio declined slightly in 2022. Profitability declined in 2022 and is well below the EU average. The high exposure of the financial sector to the housing market may represent a risk factor.

- Moderate concerns related to **government debt** remain. The government debt-to-GDP ratio decreased to 52.3% of GDP but is forecast to increase in 2023 and 2024. The government deficit narrowed to 5.7% of GDP in 2022 and is forecast to continue narrowing gradually while remaining above 4%. Fiscal sustainability risks are medium in the medium term and high in the long term ([96]).

([96]) Estimated based on the Commission's 2023 spring forecasts.

Graph 4.18: **Selected graphs: Malta**



Source: AMECO, Eurostat and European Commission

Table 4.18: **Key economic and financial indicators, Malta**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	forecast *2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**5.9**	**4.1**	**0.1**	**0.0**	**0.8**
Current account balance, balance of payments (% of GDP)		-2.0 (1)	2.6 (2)	2.2	1.2	-3.0	1.9	3.4
Net international investment position (% of GDP)	**-35%**	**-77.3 (3)**	**-17.1 (4)**	**59.4**	**97.0**	**78.8**	**81.2**	**84.6**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				265.4	114.5	111.8		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**20.3**	**8.4**	**8.6**	**1.5**	**8.5**
Nominal unit labour cost index (% y-o-y change)				11.0	-4.4	2.4	3.6	2.3
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**1.9**	**-1.2**	**-3.1**	**-1.8**	**-1.2**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				1.4	-1.1	-3.4	0.9	-0.6
Export market share - % of world exports (5 year % change)	**-6%**			**30.6**	**13.4**	**2.7**	**7.9**	**-6.3**
Export market share - % of world exports (1 year % change)				8.6	-10.2	-6.1	1.9	0.5
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**142.7**	**132.7**	**121.8**	**116.2**	**114.3**
Private sector credit flow, consolidated (% of GDP)	**14%**			**5.8**	**8.8**	**6.4**	**6.6**	**6.0**
Household debt, consolidated (% of GDP)		43.5 (6)	40.0 (7)	61.0	58.5	55.7	53.6	
Non-financial corporate debt, consolidated (% of GDP)		54.4 (6)	60.8 (7)	81.7	74.2	66.1	62.6	
Housing market								
House price index, deflated (1 year % change)	**6%**			**2.2**	**3.8**	**1.2 p**	**-2.1**	**-0.5**
House price index, nominal (1 year % change)		5.5 (8)		3.4	5.1	6.7p	3.1	3.0
Government debt								
General government gross debt (% of GDP)	**60%**			**52.2**	**54.0**	**52.3**	**53.3**	**55.8**
General government balance (% of GDP)				-9.6	-7.5	-5.7	-5.1	-4.6
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**4.9**	**11.1**	**5.9**	**0.2**	
Return on equity (%)				0.3	3.5	4.3		
Common Equity Tier 1 ratio		10.6 (9)		21.3	20.6	19.7		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				3.6e	3.0e	2.3p	2.1	
Labour market								
Unemployment rate (3 year average)	**10%**			**3.9**	**3.8**	**3.6**	**3.0**	**2.8**
Unemployment rate (year level)		3.3 (10)		4.4	3.4	2.9	2.7	2.7
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**4.9**	**3.5**	**4.1**	**3.6**	**2.6**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.9**	**-0.9**	**0.1**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**0.3**	**0.3**	**-1.0**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

THE NETHERLANDS

In the Netherlands, concerns related to the current account surplus, high private debt and house prices remain. The current account surplus warrants close monitoring, including from the perspective of euro area rebalancing.; Cost competitiveness developments in 2022 contributed to a more symmetric euro -area adjustment. Nominal house price growth turned negative, but prices are still estimated to be overvalued.

Real GDP growth reached 4.3% in 2022 and is forecast at 0.6% in 2023 and 1.1% in 2024. Headline inflation stood at -1% year-on-year in October 2023. This is below the peak of 17.1% recorded in September 2022 and below the euro area average. Core inflation also decreased, from a peak of 8.2% in May 2023 to 4.7% in October 2023, which is above the euro area average. Nominal wages per person grew less than prices in 2022, but are expected to rise faster than prices in 2023.

The scoreboard reading for the Netherlands shows that four indicators were beyond their indicative thresholds in 2022, namely the current account balance, unit labour costs, house price index, and private sector debt. Relevant developments worth highlighting:

- **External sector** concerns related to the high and long-standing current account surplus remain. In 2022, the Netherlands witnessed a decline in its substantial current account surplus, which fell from 12.1% in 2021 to 9.3%, primarily driven by a decline in the primary income and goods balances. The current account is forecast at 9.2% in 2023 and in 2024. The net international investment position fell to 75% of GDP in 2022, driven by valuation effects, but is expected to increase strongly in 2023 and 2024, owing to high current account surpluses.

- **Cost competitiveness** developments may facilitate a more symmetric euro area adjustment. Nominal unit labour costs grew on a par with the euro area average in 2022, but are expected to grow more strongly in 2023 and 2024, which may marginally contribute to facilitatinge a symmetric adjustment in the euro area. Core inflation has been above the euro area average, but headline inflation recently dropped below the euro area average with sharp falls in energy prices playing an significant role.

- The **non-financial corporate debt**-to-GDP ratio remains among the highest in the EU, although it is on a declining path. It decreased to 118% in 2022, 13 percentage points below its 2019 level, and continued falling in the first two quarters of 2023. Credit flows to non-financial corporates decreased to 4.3% as a share of GDP in 2022 and decelerated further in 2023. The high share of cross-border intra-group lending and high corporate liquidity buffers mitigate risks.

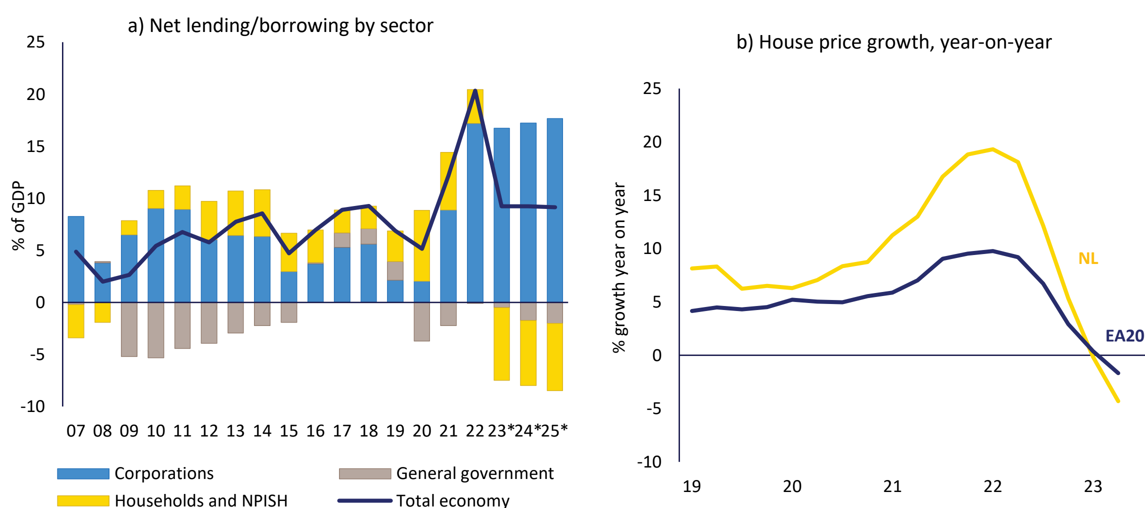
- Despite more than a decade of deleveraging, the **household debt**-to-GDP ratio is the highest in the EU, at 92%. Deleveraging is set to continue in 2023 on the back of high inflation and tightening financial conditions. As of mid-2023, around 20% of new mortgages have variable interest rates, and net interest payments have increased markedly. Risk factors include a median debt -service-to-income ratio of 41% for debt holders in the bottom quintile of the income distribution, which make up around 9% of all households in the Netherlands.

- **House prices** remain high after several years of strong growth, despite recent falls. In 2022, house prices grew by over 13%, leaving prices overvalued by an estimated 25%. As households' borrowing capacity dropped, quarterly growth rates turned negative in the second

half of 2022. However, supply constraints can be expected to keep prices elevated in the medium term.

- The **banking sector** is stable. Capitalisation dropped below the EU average in 2022. Profitability increased only marginally and is below the EU average. The non-performing loans ratio remained very low and Stage 2 loans increased slightly but remain below the EU average. Credit growth has declined amid tightening financial conditions. High exposure of the financial sector, including non-banks, to real estate, and particularly commercial real estate, which is undergoing a price correction at EU level, represents a risk factor.

Graph 4.19: **Selected graphs: The Netherlands**



Source: AMECO, Eurostat and European Commission

Table 4.19: **Key economic and financial indicators, The Netherlands**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	2023 (forecast)	2024 (forecast)
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**7.1**	**8.1**	**8.8**	**10.2**	**9.2**
Current account balance, balance of payments (% of GDP)		1.8 (1)	2.6 (2)	5.1	12.1	9.3	9.2	9.2
Net international investment position (% of GDP)	**-35%**	**-91.4 (3)**	**34.0 (4)**	**113.0**	**93.3**	**75.2**	**89.0**	**103.6**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				10.3	21.4	18.5		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**14.1**	**9.3 p**	**9.8 p**	**8.8**	**16.6**
Nominal unit labour cost index (% y-o-y change)				8.1	-2.0 p	3.6 p	7.2	5.0
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**3.7**	**2.3**	**3.2**	**1.0**	**0.9**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				1.8	0.1	1.2	2.5	0.0
Export market share - % of world exports (5 year % change)	**-6%**			**6.5**	**3.2**	**-0.1**	**-2.3**	**-3.1**
Export market share - % of world exports (1 year % change)				4.9	-2.8	-2.1	-0.7	-2.3
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**233.1**	**223.7**	**210.1 p**	**190.7**	**185.6**
Private sector credit flow, consolidated (% of GDP)	**14%**			**-0.7**	**9.6**	**6.9 p**	**6.2**	**3.7**
Household debt, consolidated (% of GDP)		47.3 (6)	67.9 (7)	103.8	98.9	92.4p	86.4	
Non-financial corporate debt, consolidated (% of GDP)		74.1 (6)	104.2 (7)	129.3	124.8	117.7	104.3	
Housing market								
House price index, deflated (1 year % change)	**6%**			**6.2**	**11.6**	**6.1**	**-10.9**	**-4.6**
House price index, nominal (1 year % change)		25.0 (8)		7.6	15.0	13.4	-3.1	-1.0
Government debt								
General government gross debt (% of GDP)	**60%**			**54.7**	**51.7**	**50.1**	**47.1**	**46.6**
General government balance (% of GDP)				-3.7	-2.2	-0.1	-0.5	-1.8
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**1.4**	**0.2**	**-3.7 p**	**1.0**	
Return on equity (%)				3.1	8.3	7.7		
Common Equity Tier 1 ratio		10.6 (9)		17.9	17.8	16.5		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				1.9e	1.4e	1.3p	1.3	
Labour market								
Unemployment rate (3 year average)	**10%**			**4.7**	**4.5**	**4.2**	**3.8**	**3.7**
Unemployment rate (year level)		4.2 (10)		4.9	4.2	3.5	3.6	3.9
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**1.2**	**1.0**	**1.3**	**1.7**	**1.6**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-1.0**	**-0.4**	**-0.2**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**0.2**	**0.4**	**-0.9**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

AUSTRIA

In Austria, house prices remain high and non-financial corporate and government debt-to-GDP ratios elevated, although associated macroeconomic risks appear to be limited. Nominal house price growth turned negative recently, but prices are still estimated to be overvalued. The corporate debt-to-GDP ratio remains high, but is declining. Government debt is decreasing, but is still higher than in 2019.

Real GDP growth reached 4.8% in 2022 and is forecast at -0.5% in 2023 and 1.0% in 2024. Headline inflation stood at 4.9% year-on-year in October 2023. This is below the peak of 11.6% recorded in October 2022 but above the euro area average. Core inflation also decreased, from a peak of 8.3% in April 2023 to 6.9% in September 2023 which is also above the euro area average. Nominal wages per person grew less than prices in 2022, but are expected to rise faster than prices in 2023.

The scoreboard reading for Austria shows that two indicators were beyond their indicative thresholds in 2022, namely unit labour costs and government debt. Relevant developments worth highlighting:

- **Cost competitiveness** concerns have increased recently. Nominal unit labour costs are expected to accelerate markedly in 2023 following more modest increases in 2022, visibly above the euro area average. The HICP-based real effective exchange rate depreciated in 2022, largely reflecting the effects of nominal depreciation of the euro; some appreciation is being observed in 2023. Core inflation has been above the euro area and, as a result, the core inflation-based real effective exchange rate has appreciated in 2023. **External sustainability** concerns remain limited.

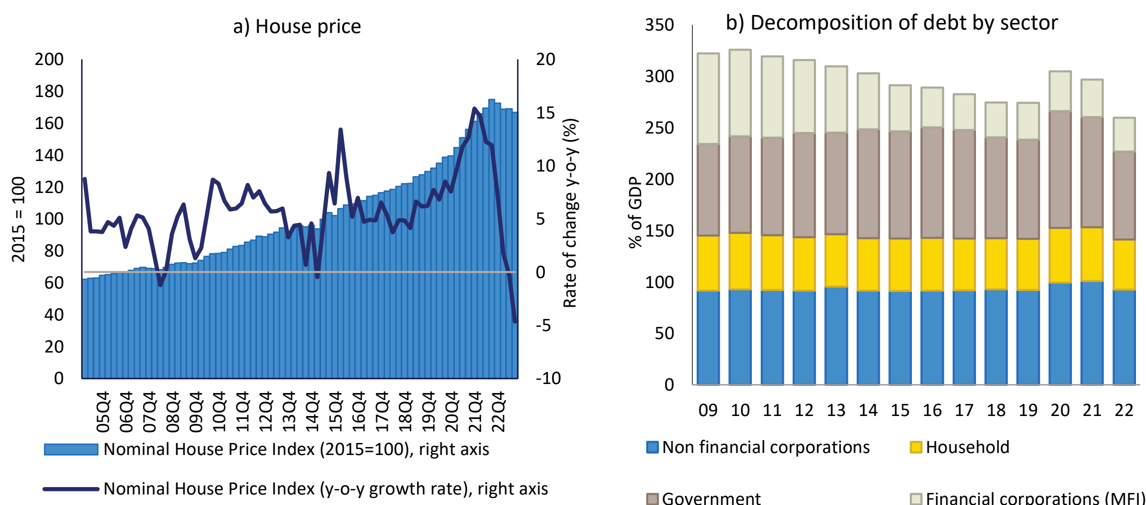
- Vulnerabilities related to the high **non-financial corporate** and **household debt**-to-GDP ratios remain, although they are on a declining path. The corporate debt-to-GDP ratio decreased to 73% in 2022, but is still slightly higher than in 2019. The household debt-to-GDP ratio stood at 49% in 2022. Half of new mortgages have variable interest rates.

- Concerns related to **house prices** remain, despite some recent moderation. Following years of noticeable growth, house prices grew by just over 11% in 2022, and are estimated to be overvalued just over 30%. Prices broadly stabilised over the later part of the year and a recent small reduction appears to have stalled in the most recent data. The stabilisation in house prices can be expected to continue as house prices adjust to higher interest rates.

- The **banking sector** is sound overall. The Common Equity Tier 1 capital ratio and profitability remained stable in 2022 and are slightly above the EU average. The non-performing loans ratio was low, but the Stage 2 ratio was well above the EU average. The existing exposure of the banking sector to Russia represents a source of risk. The provision of mortgage credit has declined significantly.

- Concerns related to **government debt** are limited and debt levels are declining. overnment debt decreased to 78.4% of GDP in 2022, and is forecast to decrease further, but remains higher than in 2019. The government deficit narrowed to 3.5% of GDP in 2022 and is forecast to continue narrowing. Fiscal sustainability risks are medium in the long term.

Graph 4.20: **Selected graphs: Austria**



Source: AMECO, Eurostat and European Commission

Table 4.20: **Key economic and financial indicators, Austria**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast *2023*	forecast *2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**2.2**	**2.5**	**1.6**	**0.7**	**0.4**
Current account balance, balance of payments (% of GDP)		1.3 (1)	0.6 (2)	3.4	1.6	-0.3	0.7	0.7
Net international investment position (% of GDP)	**-35%**	**-83.8 (3)**	**10.1 (4)**	**12.3**	**15.6**	**17.6**	**15.0**	**12.9**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-4.1	-2.6	-1.5		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**12.2**	**10.6**	**10.7**	**13.1**	**19.8**
Nominal unit labour cost index (% y-o-y change)				7.2	0.7	2.6	9.5	6.6
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**3.1**	**1.2**	**0.1**	**-0.1**	**0.1**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				2.1	0.2	-2.1	2.0	0.3
Export market share - % of world exports (5 year % change)	**-6%**			**4.9**	**-3.8**	**-4.7**	**-7.2**	**-7.9**
Export market share - % of world exports (1 year % change)				0.1	-4.4	-2.3	-0.5	-0.9
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**130.6**	**130.7**	**121.9**	**114.6**	**102.1**
Private sector credit flow, consolidated (% of GDP)	**14%**			**4.4**	**7.6**	**5.0**	**-2.3**	**-6.2**
Household debt, consolidated (% of GDP)		46.3 (6)	67.2 (7)	53.2	52.2	48.7	44.9	
Non-financial corporate debt, consolidated (% of GDP)		66.4 (6)	70.3 (7)	77.4	78.5	73.2	69.7	
Housing market								
House price index, deflated (1 year % change)	**6%**			**6.4**	**10.1**	**3.7**	**-3.3**	**-1.1**
House price index, nominal (1 year % change)		33.8 (8)		7.7	12.4	11.4	3.2	3.0
Government debt								
General government gross debt (% of GDP)	**60%**			**83.0**	**82.5**	**78.4**	**76.3**	**75.6**
General government balance (% of GDP)				-8.0	-5.8	-3.5	-2.6	-2.4
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**11.8**	**8.2**	**-3.0**	**0.6**	
Return on equity (%)				4.1	6.4	10.0		
Common Equity Tier 1 ratio		10.6 (9)		16.1	16.0	16.3		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				2.0e	1.8e	1.8p	1.7	
Labour market								
Unemployment rate (3 year average)	**10%**			**5.3**	**5.7**	**5.7**	**5.4**	**5.2**
Unemployment rate (year level)		5.3 (10)		6.0	6.2	4.8	5.3	5.4
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**-0.4**	**0.1**	**0.5**	**2.0**	**1.7**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.6**	**0.3**	**-0.2**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**1.2**	**1.0**	**0.4**		

Notes: See Annex 1
Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

POLAND

In Poland, developments related to unit labour costs and the high fiscal deficit are of increasing relevance. Nominal unit labour costs increased visibly, and are expected to grow even more markedly this year. Inflation remains above the euro area average, amid recently looser monetary policy and an increasing government deficit.

Real GDP growth reached 5.3% in 2022 but is forecast at 0.4% in 2023 and 2.7% in 2024. Headline inflation stood at 7.7% year-on-year in September 2023. This is below the peak of 17.2% recorded in February 2023 but above the EU and euro area averages. Core inflation also decreased, from a peak of 12% in November 2022, to 7.4% in September 2023, which is also above the EU and euro area averages. Nominal wages per person grew broadly in line with prices in 2022, and are expected to also do so in 2023.

The scoreboard reading for Poland shows that one indicator was beyond its indicative threshold in 2022, namely unit labour costs. Relevant developments worth highlighting:

- **External sustainability** concerns remain contained. The current account deficit increased from 1.3% in 2021 to 2.4% in 2022 due to a decrease in both the non-energy and energy goods balances. As domestic demand weakened in the first half of 2023, the current account balance improved to -0.1%. The current account balance is expected to return to surplus in 2023, at 1.4% of GDP and remain broadly stable in 2024. The net international investment position (NIIP) slightly improved in 2022 to -33% and is no longer beyond the indicative scoreboard threshold. The NIIP excluding non-defaultable loan instruments was broadly in balance. The NIIP is projected to continue improving over the forecast period.

- **Cost competitiveness** concerns have been increasing. Nominal unit labour costs increased visibly in 2022, and are expected to grow even more markedly in 2023. Unit labour costs growth in 2022 and 2023 is well in excess of the euro area trading partners and the rest of the EU. Those patterns have been driven by very significant nominal wage increases amid high inflation in a tight labour market. Wage increases were mitigated by large labour productivity gains in 2022 but not in 2023, amid a stagnant economy. Both headline and core inflation have been above the euro area and EU averages even if both have declined visibly since late 2022. The HICP-based real effective exchange rate depreciated marginally in 2022 amid a sizeable nominal depreciation. However, strong appreciations of both the HICP and core-inflation based real effective exchange rates have taken place in 2023 driven by much higher inflation rates at home than in trading partners, as well as nominal appreciation. In September 2023, the Monetary Policy Council cut the National Bank of Poland reference rate by 75 basis points to 6.0%, which was followed by depreciation of the zloty against the euro.

- The **household debt**-to-GDP ratio is low, at 27% in 2022, and is set to decline further in 2023. Credit flows turned negative in 2022 as interest rates for new loans surpassed the 8% mark. By mid-2023, around 35% of new loans had a variable rate (<1 year fixation period), down from around 100% a decade ago. The gross savings rate dropped from 4.6% to -0.8% over 2019-2022, the lowest in the EU, but is set to pick up in the future. Non-performing loans declined to 4.8% of all loans to households by mid-2023, a still relatively high level. The **non-financial corporate debt**-to-GDP ratio has been decreasing from a low level.

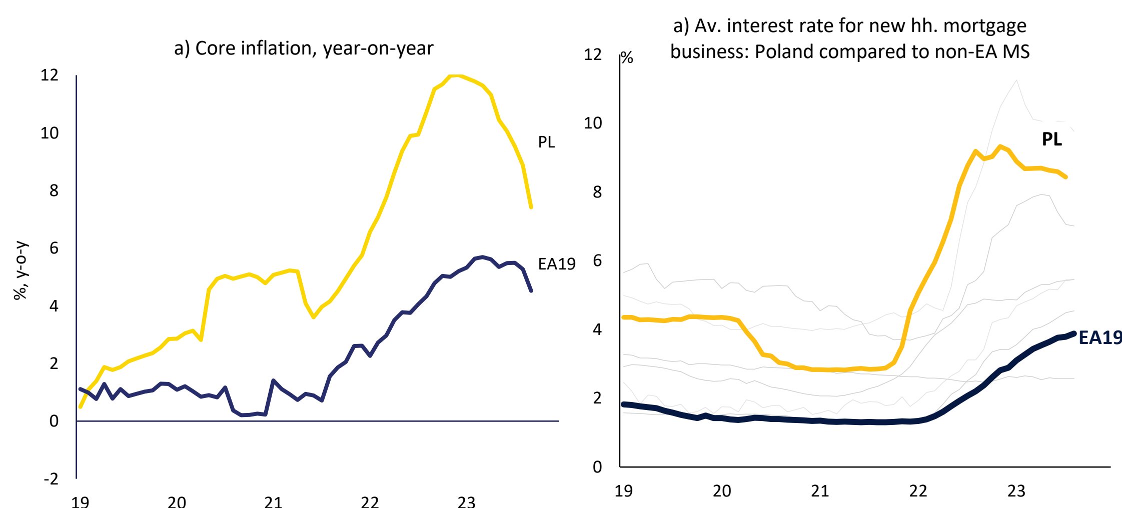
- **House price** growth dynamics are of limited concern. Nominal house prices grew by almost 12% in 2022 on the back of strong increases in incomes, a continuation of recent trends. However, this year prices have moderated , and house prices showed some stability before

growing again in the last quarter. Given that house price growth was muted before the pandemic, house prices are now broadly in line with incomes. House prices have declined in real terms in 2022 and are expected to do so also in 2023. Some moderation in nominal levels could occur following the increase in interest rates, which affected borrowing capacity significantly in 2022. While the change in borrowing capacity is expected to stabilise, some delayed impact on house prices can still occur in 2023.

- The **banking sector** remains sound. Profitability increased in 2022 and is, together with the capital ratio, slightly below the EU average. In the future, the profitability of banks can be affected by legal risks related to previously granted foreign currency mortgages. The overall non-performing loans ratio remained stable in 2022, but at 4.3% (as of first quarter of 2023) is well above the EU average. After a significant increase in interest rates in 2022, the credit dynamics slowed down significantly.

- Concerns related to **government debt** remain limited for now, but the increasing deficit is a concern. The government debt-to-GDP ratio decreased in 2022 to 49.3%. It is forecast to increase in 2023 and 2024, but is still set to remain below the Treaty reference value of 60% of GDP. The fiscal deficit widened to 3.7% of GDP in 2022 and is forecast to increase substantially in 2023. It is also forecast to remain above 4% in 2024. Fiscal sustainability risks are medium both in the medium- and long-term ([97]).

Graph 4.21: **Selected graphs: Poland**



Source: AMECO, Eurostat and European Commission

([97]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.21: **Key economic and financial indicators, Poland**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	2023 (forecast)	2024 (forecast)
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**0.1**	**0.3**	**-0.4**	**-0.8**	**0.1**
Current account balance, balance of payments (% of GDP)		0.3 (1)	-2.8 (2)	2.5	-1.3	-2.4	1.4	1.2
Net international investment position (% of GDP)	**-35%**	**-55.4 (3)**	**-5.1 (4)**	**-43.9**	**-39.8**	**-33.4**	**-28.1**	**-25.1**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-4.5	0.7	2.7		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**14.0**	**12.1**	**16.9 p**	**21.1**	**28.1**
Nominal unit labour cost index (% y-o-y change)				7.5	0.4	8.4 p	11.3	6.1
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**1.1**	**-0.4**	**-0.2**	**7.3**	**9.4**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				1.1	-0.5	-0.7	7.2	1.4
Export market share - % of world exports (5 year % change)	**-6%**			**33.3**	**23.7**	**16.6**	**9.7**	**4.9**
Export market share - % of world exports (1 year % change)				11.2	-1.4	-0.9	-2.6	-0.9
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**76.1**	**71.3**	**63.5**	**56.9**	**55.1**
Private sector credit flow, consolidated (% of GDP)	**14%**			**1.8**	**3.8**	**1.9**	**2.7**	**2.7**
Household debt, consolidated (% of GDP)		41.9 (6)	18.6 (7)	34.6	32.2	26.6	23.7	
Non-financial corporate debt, consolidated (% of GDP)		61.8 (6)	27.9 (7)	41.5	39.1	36.9	33.2	
Housing market								
House price index, deflated (1 year % change)	**6%**			**6.7**	**3.5**	**-1.9**	**-8.1**	**-2.0**
House price index, nominal (1 year % change)		1.9 (8)		10.5	9.2	11.8	2.1	4.0
Government debt								
General government gross debt (% of GDP)	**60%**			**57.2**	**53.6**	**49.3**	**50.9**	**54.4**
General government balance (% of GDP)				-6.9	-1.8	-3.7	-5.8	-4.6
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**11.6**	**12.3**	**3.0**	**1.3**	
Return on equity (%)				3.1	4.8	7.3		
Common Equity Tier 1 ratio		10.6 (9)		17.5	16.1	16.3		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				6.0e	5.0e	4.3p	4.4	
Labour market								
Unemployment rate (3 year average)	**10%**			**3.5**	**3.3**	**3.2**	**3.1**	**2.9**
Unemployment rate (year level)		2.8 (10)		3.2	3.4	2.9	3.0	2.8
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**1.4**	**3.4**	**3.6**	**3.8**	**1.4**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.9**	**-0.1**	**0.2**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-4.0**	**0.1**	**0.9**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

PORTUGAL

In Portugal, concerns related to household and non-financial corporate, government and external debt-to-GDP ratios remain but debt ratios have continued to decrease. Nominal house price growth moderated in recent quarters, but prices are still estimated to be overvalued. Risks associated with financial and public sector feedback loops remain but have decreased.

Real GDP growth reached 6.8% in 2022 and is forecast at 2.2% in 2023 and 1.3% in 2024. Headline inflation stood at 3.3% year-on-year in October 2023. This is below the peak of 10.6% recorded in October 2022 but above the euro area average. Core inflation also decreased, from a peak of 6.5% in May 2023, to 5.1% in September 2023 which is also above the euro area average. Nominal wages per person grew less than prices in 2022 but are expected to grow more than prices in 2023.

The scoreboard reading for Portugal shows that four indicators were beyond their indicative thresholds in 2022, namely the net international investment position, unit labour costs, private sector debt, and government debt. Relevant developments worth highlighting:

- **External sustainability** concerns continue to subside despite a small reduction in the current account in 2022. The current account balance declined to -1.1% of GDP in 2022. In the second quarter of 2023, the annualised current account moved to a surplus of 0.6% of GDP due to a rebound in the energy and travel balances. The current account is forecast to increase to 1.6% of GDP in 2023. The net international investment position continued improving in 2022, from -94% in 2021 to -84% of GDP, and a further increase is expected for 2023. Cost competitiveness concerns remain limited.

- Vulnerabilities related to the high **non-financial corporate debt**-to-GDP ratio remain but are on a declining path. It declined to 80% in 2022 and continued falling in the first two quarters of 2023. The debt ratio is below its level in 2019.

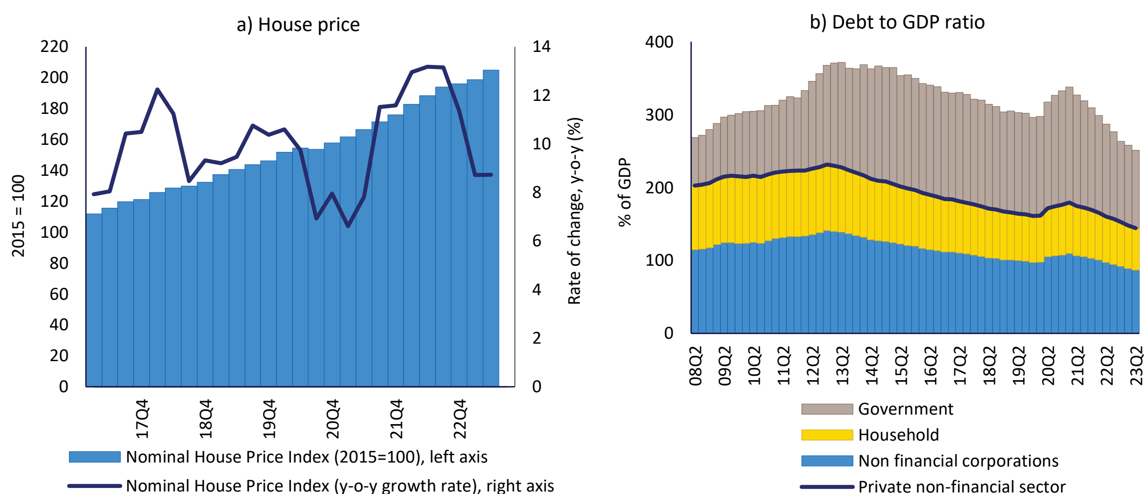
- The **household debt**-to-GDP ratio continued to decrease in 2022, but remains elevated, at 61%. It has been on a downward trend since 2009, with a temporary uptick in 2020. Deleveraging is set to continue at a fast pace in 2023. Risk factors include a high share of variable rate loans, at 68% of new loans in mid-2023, and a modest savings rate. On the upside, real wages and employment are set to grow in 2023. A series of temporary policy support measures have been introduced to mitigate the impact of rising interest rates on housing loans.

- **House prices** remain a concern. They grew by over 12% in 2022, building on years of increases above income. As a result, house prices are estimated to be overvalued by 20-25%. Despite some moderation in recent quarters, house price growth continues amid strong demand, including from foreign investors, and a slowdown in the construction of new buildings.

- The **banking sector** recorded a strong performance in 2022 while some vulnerabilities remain. The CET1 capital ratio increased, reaching all-time highs and above the euro area average. Profitability improved markedly in 2022 and the first half of 2023, above the euro area average. The non-performing loans ratio declined, but at 3.1% as of the second quarter of 2023 remains above the EU average, as do Stage 2 loans. Credit dynamics were very muted since the tightening of financial conditions in mid-2022. Risks associated with financial and public sector feedback loops remain but have decreased, partly due to banks’ reduced exposures to sovereign bonds and to improvements in banks’ and fiscal performance.

- Concerns related to **government debt** remain but are declining. In 2022, government debt decreased considerably, by nearly 12 percentage points, reaching 112.4% of GDP. This is already below pre-pandemic levels, and the ratio is expected to further contract over the forecast period. The general government deficit narrowed to 0.3% of GDP in 2022 and is forecast to turn into a surplus in 2023. Fiscal sustainability risks are low in the short term and high in the medium term ([98]).

Graph 4.22: **Selected graphs: Portugal**



Source: AMECO, Eurostat and European Commission

([98]) Estimated based on the Commission's 2023 spring forecasts.

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

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

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

ROMANIA

In Romania, concerns related to cost competitiveness, external sustainability and the government deficit remain substantial. Although declining and largely financed from sustainable sources, the current account deficit is set to remain large and the government deficit remains very high. Nominal unit labour costs are forecast to grow strongly, in the face of labour shortages, while core inflation has been well above the EU average and is increasing further.

Real GDP growth reached 4.6% in 2022 and is forecast at 2.2% in 2023 and 3.1% in 2024. Headline inflation stood at 9.2% year-on-year in September 2023. This is below the peak of 14.6% recorded in November 2022, but above the EU and euro area averages. Core inflation increased to 11.6% in September 2023, which is also above the EU and euro area averages. Nominal wages per person grew less than prices in 2022, and are expected to grow more than prices in 2023.

The scoreboard reading for Romania shows that two indicators were beyond their indicative thresholds in 2022, namely the current account balance and net international investment position. Relevant developments worth highlighting:

- The **external sustainability** outlook worsened in 2022, with the current account deficit increasing from 7.2% in 2021 to 9.1%. This deterioration adds to a decade of gradual increases in the deficit, and is mainly due to a significant decline in the balance of goods, both energy and non-energy, with a smaller impact also from primary income. In the second quarter of 2023, the deficit narrowed to 7.4% mainly due to a rebound in the goods balance. The current account deficit is set to remain large, at around 7% in 2023 and 2024, but direct investment and EU fund inflows remain a significant source of the current account financing. The net international investment position improved in 2022, reaching -41% of GDP, driven by strong nominal GDP growth and favourable valuation effects. A slight decline is projected for 2024. The net international investment position, excluding non-defaultable instruments, remains close to balance.

- **Cost competitiveness** concerns are rising due to a strong increase in nominal wages in 2023. Nominal unit labour costs increased in 2022, although not as much as in peer countries, and were mitigated by strong productivity gains. However, the increase in unit labour costs adds to several years of continued marked increases before the pandemic. Unit labour costs are expected to grow much more strongly in 2023, exceeding those in the rest of the EU. The HICP-based real effective exchange rate appreciated moderately in 2022 driven by higher inflation at home and against a backdrop of a stable exchange rate against the euro. An appreciation of the core inflation-based real effective exchange rate took place in 2022 and clearly continues in 2023 amid further rises in core inflation in recent months, bringing it into double-digit territory.

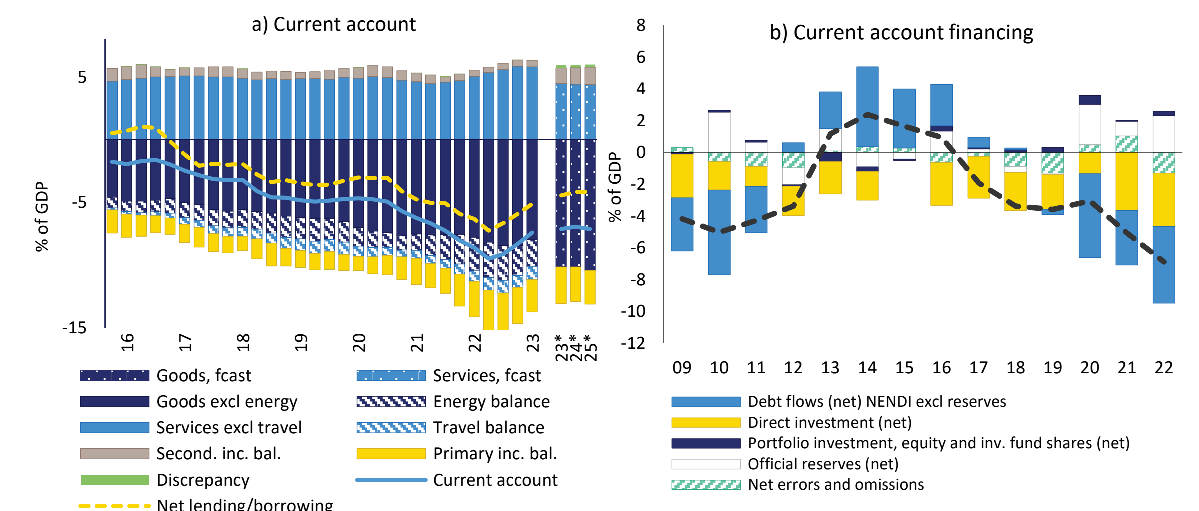
- The **non-financial corporate debt**-to-GDP ratio decreased, to 29% in 2022, slightly below its 2019 level, and continued to decrease slightly in the first half of 2023. The share of domestic corporate loans denominated in foreign currency is high, at 45%, and increased in the first half of 2023. Non-financial corporate vulnerabilities are mitigated by high and increasing profit shares and savings.

- The **household debt**-to-GDP ratio stood at 14% in 2022, the lowest level in the EU, and is expected to decrease further in 2023.

- The **banking sector** is stable. While the Common Equity Tier 1 capital ratio is close to the EU average, profitability was the highest in the EU in 2022. The non-performing loans ratio of the banking sector declined in 2022, but at 2.8% (as of first quarter of 2023) remains above the EU average. Following monetary tightening, the lending rates have also increased significantly, which contributed to the moderation of previously very dynamic credit growth from mid-2022.

- The **government deficit** remains high. It improved in 2022, at 6.3% of GDP, but the structural balance remained largely unchanged. Government debt fell to 47.2% of GDP in 2022 helped by strong nominal growth. However, it is forecast to increase in the coming years, as growth slows down and the deficit remains high. It continues to be noticeably higher than the pre-COVID levels. Sovereign bond yields are among the highest in the EU and currency risks are high, with around half of central government debt denominated in foreign currencies, and about half held by non-residents at the end of 2022. Fiscal sustainability risks are medium in the medium and long term ([99]).

Graph 4.23: **Selected graphs: Romania**



Source: AMECO, Eurostat and European Commission

([99]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.23: **Key economic and financial indicators, Romania**

	Thresholds	*Benchmark I*	*Benchmark II*	*2020*	*2021*	*2022*	forecast	
							2023	*2024*
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**-4.8**	**-5.7**	**-7.1**	**-7.8**	**-7.7**
Current account balance, balance of payments (% of GDP)		0.1 (1)	-4.5 (2)	-4.9	-7.2	-9.1	-7.1	-6.9
Net international investment position (% of GDP)	**-35%**	**-49.3 (3)**	**-8.1 (4)**	**-47.6**	**-47.0**	**-40.6**	**-39.9**	**-41.2**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-7.0	-6.5	-4.2		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**20.7**	**14.7 p**	**10.4 p**	**17.3**	**22.3**
Nominal unit labour cost index (% y-o-y change)				5.8	1.4 p	2.9 p	12.4	5.7
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**3.4**	**1.0**	**2.6**	**10.2**	**11.7**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				1.4	0.0	1.2	4.4	1.4
Export market share - % of world exports (5 year % change)	**-6%**			**19.5**	**9.6**	**6.7**	**3.3**	**1.0**
Export market share - % of world exports (1 year % change)				1.9	-0.2	0.0	0.2	-0.9
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**48.0**	**47.8**	**43.3 p**	**39.0**	**37.0**
Private sector credit flow, consolidated (% of GDP)	**14%**			**1.3**	**3.8**	**3.3 p**	**1.9**	**1.4**
Household debt, consolidated (% of GDP)		55.2 (6)	12.8 (7)	16.1	15.8	13.9p	12.4	
Non-financial corporate debt, consolidated (% of GDP)		68.4 (6)	22.0 (7)	31.9	32.0	29.4	26.6	
Housing market								
House price index, deflated (1 year % change)	**6%**			**2.3**	**-0.2**	**-6.2**	**-7.8**	**-3.7**
House price index, nominal (1 year % change)		-21.4 (8)		4.7	4.4	7.2	1.3	2.0
Government debt								
General government gross debt (% of GDP)	**60%**			**46.8**	**48.5**	**47.2**	**47.9**	**48.9**
General government balance (% of GDP)				-9.3	-7.2	-6.3	-6.3	-5.3
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**13.4**	**14.3**	**8.2**	**0.6**	
Return on equity (%)				9.0	13.1	15.7		
Common Equity Tier 1 ratio		10.6 (9)		21.8	19.9	19.2		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				3.9e	3.4e	2.8p	2.7	
Labour market								
Unemployment rate (3 year average)	**10%**			**5.4**	**5.5**	**5.8**	**5.5**	**5.4**
Unemployment rate (year level)		5.4 (10)		6.1	5.6	5.6	5.4	5.2
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**2.3**	**3.2**	**3.5**	**2.6**	**1.1**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.6**	**-0.2**	**0.2**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**-1.4**	**0.5**	**1.8**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

SLOVENIA

In Slovenia, cost competitiveness pressures persist, house prices continue to grow strongly and the government deficit remains elevated, but associated macroeconomic risks appear to be limited. Supply side constraints, high inflation and unit labour cost growth may weigh on medium-term competitiveness and growth.

Real GDP growth reached 2.5% in 2022 and is forecast at 1.3% in 2023 and 2.0% in 2024. Headline inflation stood at 6.6% year-on-year in October 2023. This is below the peak of 11.7% recorded in July 2022 but above the euro area average. Core inflation also decreased, from a peak of 7.6% in April 2023, to 6.6% in September 2023 which is also above the euro area average. Nominal wages per person grew less than prices in 2022, but are expected to grow more than prices in 2023.

The scoreboard reading for Slovenia shows that three indicators were beyond their indicative thresholds in 2022, namely unit labour costs, government debt, and the youth unemployment rate. Relevant developments worth highlighting:

- **External sustainability** concerns remain limited. In 2022, the current account balance fell sharply, from a surplus of 3.3% in 2021 to a deficit of -1%. This change was primarily driven by a decrease in the balance of non-energy goods, and a deacrease in the energy balance to a lesser extent. The balance of trade in goods improved in the second quarter of 2023, resulting in a current account surplus of 2.7%. The net international investment position (NIIP) came in close to balance in 2022 and is projected to improve slightly in 2023 and 2024. The NIIP net of non-defaultable instruments is positive.

- **Cost competitiveness** concerns have increased recently. Increases in nominal unit labour costs were sizeable in 2022, and are accelerating further in 2023. Moreover, they are growing faster than in the rest of the euro area, driven by significantly higher wage increases amid limited productivity gains. The HICP-based real effective exchange rate depreciated in 2022, but appreciation is being observed in 2023. When measured on the basis of core inflation, the real effective exchange rate was broadly stable in 2022 and is displaying some appreciation in 2023 amid higher core inflation than in the euro area in both years.

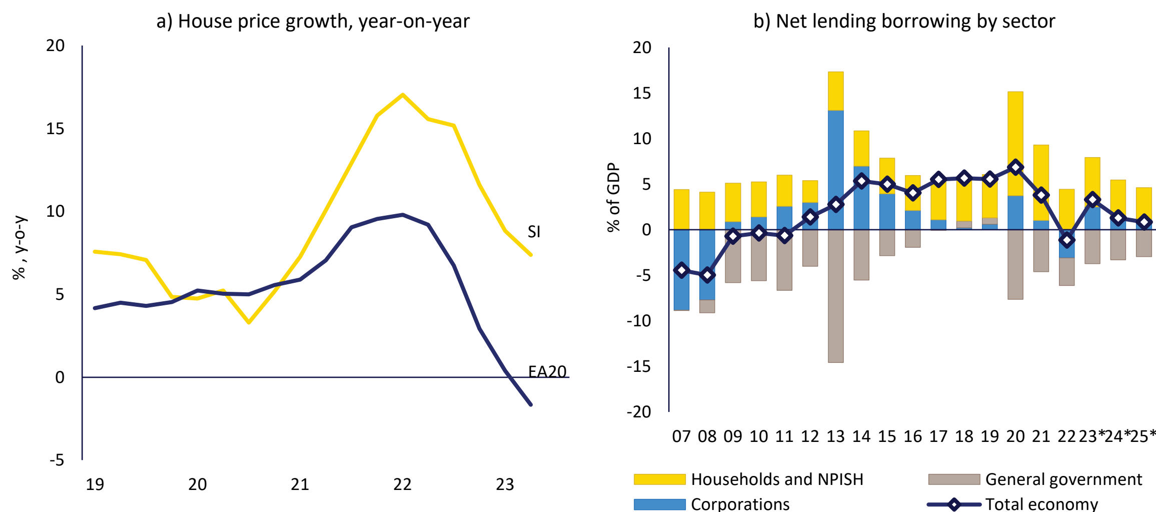
- **House price** growth remains a concern, despite some moderation. It accelerated to nearly 15% in 2022, building on strong growth in recent years that has left house prices overvalued by nearly 10%. House price growth has moderated in recent quarters. Both household and non-financial corporations' debt-to-GDP ratios remain low.

- The **banking sector** is sound. While capitalisation is below the EU average, profitability was one of the highest in the EU in 2022. The non-performing loans ratio kept decreasing in 2022 and at 1.6% (as of first quarter of 2023) is close to the EU average. Credit growth was very dynamic in the first half of 2022, but slowed down in late 2022 amid tightening financial conditions. The increase in house prices in recent years represents a source of risk.

- Concerns related to the **government debt** remain, but are declining. Government debt decreased to 72.3% of GDP in 2022, above its pre-pandemic level, and is forecast to continue declining. The government deficit remains high but decreased to 3% of GDP in 2022. It is

forecast to temporarily increase again in 2023 and remain above 3% in 2024. Fiscal sustainability risks are medium in the medium-term and high in the long term ([100]).

Graph 4.24: **Selected graphs: Slovenia**



Source: AMECO, Eurostat and European Commission

([100]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.24: **Key economic and financial indicators, Slovenia**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	2023 (forecast)	2024 (forecast)
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**6.3**	**5.5**	**3.2**	**1.9**	**1.4**
Current account balance, balance of payments (% of GDP)		0.6 (1)	0.1 (2)	7.2	3.3	-1.0	3.5	1.7
Net international investment position (% of GDP)	**-35%**	**-63.5 (3)**	**3.0 (4)**	**-15.7**	**-7.7**	**-1.5**	**3.9**	**8.8**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				1.4	9.4	15.2		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**14.3**	**12.7**	**14.3**	**16.2**	**20.4**
Nominal unit labour cost index (% y-o-y change)				7.2	1.1	5.4	9.0	4.8
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**1.7**	**-0.4**	**-1.3**	**1.5**	**1.7**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				0.4	-0.3	-1.3	2.4	-0.1
Export market share - % of world exports (5 year % change)	**-6%**			**19.3**	**10.6**	**2.9**	**-2.8**	**-4.0**
Export market share - % of world exports (1 year % change)				1.7	-1.2	-1.9	-1.9	-0.7
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**69.5**	**66.2**	**66.0**	**61.0**	**58.7**
Private sector credit flow, consolidated (% of GDP)	**14%**			**-0.9**	**3.5**	**5.2**	**1.2**	**1.1**
Household debt, consolidated (% of GDP)		45.0 (6)	36.0 (7)	27.7	26.3	25.9	24.1	
Non-financial corporate debt, consolidated (% of GDP)		62.1 (6)	55.6 (7)	41.8	39.9	40.1	36.9	
Housing market								
House price index, deflated (1 year % change)	**6%**			**5.2**	**7.9**	**4.3**	**-2.6**	**0.1**
House price index, nominal (1 year % change)		11.1 (8)		4.6	11.5	14.8	4.7	4.0
Government debt								
General government gross debt (% of GDP)	**60%**			**79.6**	**74.4**	**72.3**	**69.3**	**68.4**
General government balance (% of GDP)				-7.6	-4.6	-3.0	-3.7	-3.3
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**14.0**	**14.1**	**-1.4**	**1.3**	
Return on equity (%)				11.3	9.5	13.3		
Common Equity Tier 1 ratio		10.6 (9)		16.7	16.9	15.9		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				3.0e	2.1e	1.8p	1.5	
Labour market								
Unemployment rate (3 year average)	**10%**			**4.8**	**4.7**	**4.6**	**4.1**	**3.8**
Unemployment rate (year level)		5.5 (10)		5.0	4.8	4.0	3.6	3.7
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.2**	**0.6**	**1.6**	**2.9**	**2.3**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-1.2**	**-0.3**	**-0.3**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**3.0**	**3.9**	**2.0**		

Notes: See Annex 1
Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

SLOVAKIA

In Slovakia, concerns related to cost competitiveness, external accounts, government finances, house prices and household debt persist. Nominal unit labour cost growth is set to increase further, and core inflation remains well above the euro area overall. Nominal house price growth turned negative recently, but prices still show signs of overvaluation. The current account deficit remains sizeable, even if it is declining, and the fiscal deficit which is set to return to high levels, warranting close monitoring.

Real GDP growth reached 1.8% in 2022 and is forecast at 1.3% in 2023 and 1.7% in 2024 Headline inflation stood at 7.8% year-on-year in October 2023. This is below the peak of 15.4% recorded in February 2023 but above the euro area average. Core inflation also decreased, from a peak of 11.9% in February 2023, to 7.8% in October 2023, which is also above the euro area average. Nominal wages per person grew less than prices in 2022 and are expected to also do so in 2023.

The scoreboard reading for Slovakia shows that four indicators were beyond their indicative thresholds in 2022, namely the net international investment position, the export market share, unit labour costs and the youth unemployment rate. Relevant developments worth highlighting:

- The **external sustainability** outlook deteriorated significantly in 2022. The current account worsened from -4% in 2021 to -7.3% of GDP in 2022. The deterioration was driven by the energy balance and, to a lesser extent, by the non-energy goods balance. The deficit fell to 4.2% in the second quarter of 2023, owing to a lower energy goods deficit. For 2023 and 2024, slightly lower but still sizeable deficits are expected, at 2.7% and 3.4% respectively. The negative net international investment position (NIIP) remained largely unchanged at -61% of GDP in 2022, close to its average since the adoption of the euro. The NIIP is expected to improve slightly in 2023 and remain stable in 2024. The bulk of the NIIP consists of direct investment. The NIIP net of non-defaultable instruments fell to -18.2% in 2022, the lowest level in two decades.

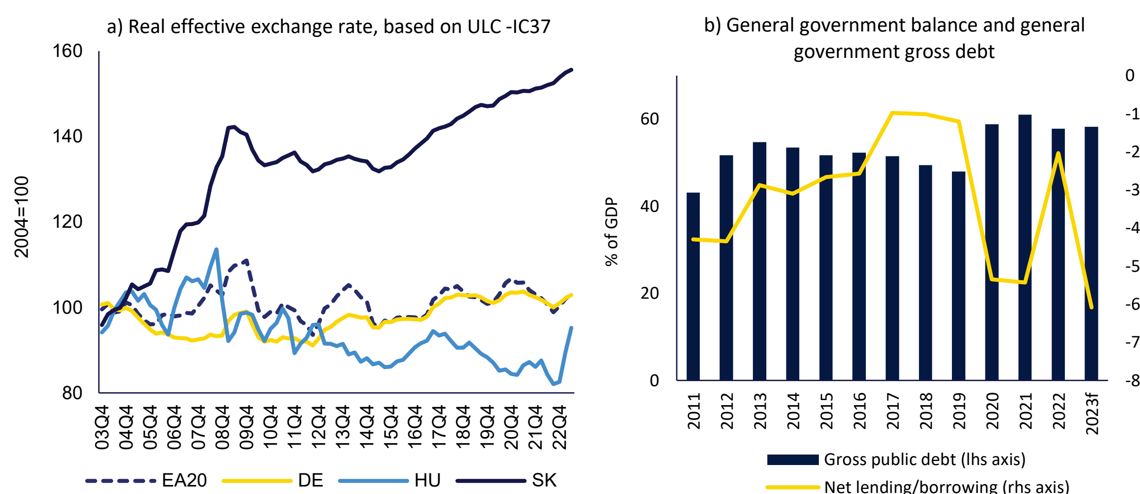
- **Cost competitiveness** concerns persist and are widening. After several years of continued increases, nominal unit labour costs increased significantly in 2022, on account of large nominal wage increases and falling output per worker. In 2023, unit labour costs growth is expected to accelerate again, more than in the euro area. The HICP-based real effective exchange rate appreciated in 2022, on account of the much higher inflation at home relative to most trading partners and despite some nominal depreciation of the euro. However, it remained broadly stable when measured against the GDP deflator. The real effective exchange rate appreciated even more strongly when measured based on core inflation. Further significant appreciations are underway in 2023.

- In 2022, the **household debt**-to-GDP ratio continued its upward trend observed over the last two decades despite high nominal GDP growth, helped by dynamic borrowing. This brought the ratio to 47%, relatively high compared with regional peers. The ratio is expected to decrease in 2023 on the back of still high inflation. Credit flows are abating only slowly despite a fourfold increase in the cost of borrowing (albeit from a low basis). The gross savings rate halved to 5% between 2021 and 2022 , as real gross disposable income contracted while real consumption expanded amidst high inflation. The low savings rate is set to gradually recover over the forecast period. The **non-financial corporate debt**-to-GDP ratio remained unchanged but moderate, at 46% in 2022.

- **House prices** remain a concern, although growth has moderated strongly. House price growth accelerated to 13.7% in 2022, building on years of sizeable increases. However house price growth moderated in 2022, and real house prices have been falling since the last quarter of 2022. In the short term there may be some further moderation, which would contribute to the closing of a valuation gap of around 10%. The **banking sector** is sound. The non-performing loans ratio and profitability decreased slightly in 2022 and are close to the EU average. Mortgage credit has been very dynamic and represents a source of risk amid a significant increase in house prices and household indebtedness in recent years. However, this growth in mortgage credit has slowed recently due to the increase in mortgage interest rates.

- Concerns related to **government debt** are still contained for now, but are increasing. Government debt decreased to 57.8% of GDP in 2022 mainly thanks to high GDP growth driven by strong inflation. Government debt is expected to still decrease slightly in 2023, while an increase is expected for 2024. The government deficit has improved and reached 2% of GDP in 2022, but is forecast to almost triple in 2023 and further increase in 2024, achieving the largest deficit estimate in the EU. Fiscal sustainability risks are high both in the medium and long term due to population ageing ([101]).

Graph 4.25: **Selected graphs: Slovakia**



Source: AMECO, Eurostat and European Commission

([101]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.25: **Key economic and financial indicators, Slovakia**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	forecast 2023	2024
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**-1.7**	**-2.2**	**-3.6**	**-4.7**	**-4.5**
Current account balance, balance of payments (% of GDP)		0.0 (1)	-1.3 (2)	0.6	-4.0	-7.3	-2.7	-3.4
Net international investment position (% of GDP)	**-35%**	**-49.6 (3)**	**-4.0 (4)**	**-64.7**	**-60.5**	**-61.0**	**-57.2**	**-56.9**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-14.8	-14.4	-18.2		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**15.4**	**12.6**	**13.3**	**17.0**	**22.5**
Nominal unit labour cost index (% y-o-y change)				5.4	1.4	6.0	8.9	6.2
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**5.2**	**3.1**	**3.8**	**3.9**	**5.4**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				2.5	0.0	1.3	3.7	1.4
Export market share - % of world exports (5 year % change)	**-6%**			**7.2**	**-1.9**	**-6.6**	**-10.5**	**-6.3**
Export market share - % of world exports (1 year % change)				3.2	-3.0	-6.2	-2.3	2.1
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**94.8**	**92.6**	**92.7**	**85.7**	**83.8**
Private sector credit flow, consolidated (% of GDP)	**14%**			**2.6**	**4.5**	**9.3**	**5.9**	**3.8**
Household debt, consolidated (% of GDP)		47.8 (6)	29.1 (7)	46.5	47.0	47.1	43.6	
Non-financial corporate debt, consolidated (% of GDP)		67.8 (6)	45.5 (7)	48.3	45.6	45.6	42.1	
Housing market								
House price index, deflated (1 year % change)	**6%**			**7.2**	**3.0**	**1.3**	**-10.3**	**-3.2**
House price index, nominal (1 year % change)		10.9 (8)		9.6	6.4	13.7	-1.2	2.1
Government debt								
General government gross debt (% of GDP)	**60%**			**58.9**	**61.1**	**57.8**	**56.7**	**59.9**
General government balance (% of GDP)				-5.4	-5.2	-2.0	-5.7	-6.5
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**9.6**	**23.7**	**-9.3**	**2.3**	
Return on equity (%)				5.3	8.4	9.4		
Common Equity Tier 1 ratio		10.6 (9)		16.8	16.7	16.8		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				2.5e	2.0e	1.7p	1.8	
Labour market								
Unemployment rate (3 year average)	**10%**			**6.3**	**6.4**	**6.5**	**6.2**	**5.7**
Unemployment rate (year level)		6.3 (10)		6.7	6.8	6.1	5.7	5.4
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.4**	**0.2**	**1.4**	**1.3**	**1.2**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-2.2**	**-0.8**	**0.2**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**0.4**	**4.8**	**2.8**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

FINLAND

In Finland, household debt is high, although associated macroeconomic risks appear to be limited. Household debt continuesto fall, but almost all loans for house purchase are at variableinterest rates, which exposes households to the risks of interest rate hikes. The banking system appears sound and resilient, despite significant cross-border exposures, especially with other Nordic countries.

Real GDP growth reached 1.6% in 2022 and is forecast at 0.1% in 2023 and 0.8% in 2024. Headline inflation stood at 2.4% year-on-year in October 2023. This is below the peak of 9.1% recorded in November 2022 and below the euro area average. Core inflation also decreased, from a peak of 5.2% in March 2023, to 3.6% in October 2023, which is also below the euro area average. Nominal wages per person grew less than prices in 2022, but are expected to grow more than prices in 2023.

The scoreboard reading for Finland shows that two indicators were beyond their indicative thresholds in 2022, namely private sector debt and government debt. Relevant developments worth highlighting:

- Risks related to **external sustainability** are contained. The current account deteriorated from 0.4% of GDP in 2021 to -2.5% in 2022, but the deficit is expected to narrow to -0.5% in 2023. The net international investment position (NIIP) is projected to remain close to its 2022 level of -1.7% of GDP in both 2023 and 2024. The NIIP net of non-defaultable instruments was positive.

- **Cost competitiveness** concerns remain limited. Nominal unit labour costs increased visibly in 2022 and a somewhat stronger growth rate is expected for 2023. However, unit labour costs growth is expected to come in below that of the euro area in 2023. The HICP-based and core inflation-based real effective exchange rates depreciated visibly in 2022, while some appreciation has been observed in 2023.

- Vulnerabilities related to the elevated **non-financial corporate debt**-to-GDP ratio remain, although the ratio is on a declining path. It decreased to 79% in 2022, slightly below its 2019 level, and continued falling slightly in the first half of 2023.

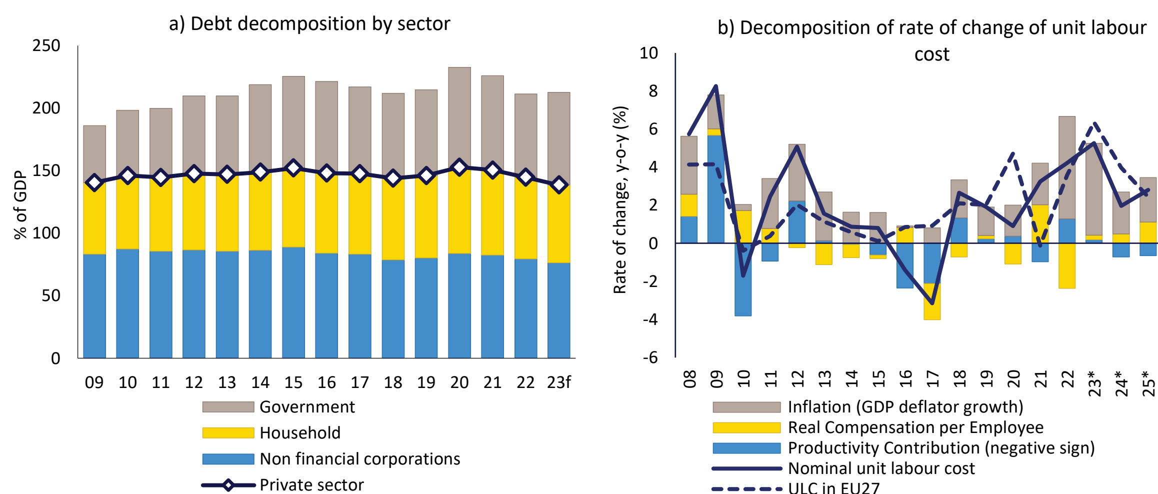
- The **household debt**-to-GDP ratio is high, at 65% in 2022. After doubling over 2000-2020, a reduction has been underway since 2021 on the back of strong nominal output growth. This is set to continue in 2023, helped by high inflation and a strong increase in interest rates. Virtually all new loans have a variable interest rate, increasing the vulnerabilities associated with household debt. Savings are modest, at 8% of gross disposable income. On the upside, real wage growth is set to pick up.

- **House prices** started to fall in mid-2022 after having recorded a moderate growth in the beginning of 2022. Strong increases in interest rates and slowing economic growth are expected to add to the negative momentum, but prices are likely to stabilise as supply constraints bite. House prices are estimated to be slightly undervalued.

- The **banking sector** is sound. Capitalisation and profitability of the banking sector are close to the EU average and the non-performing loans ratio is below 1% (as of first quarter of 2023). A correction of house prices represents a risk amid significant household debt and a high share of mortgage debt with variable interest rates.

- Concerns related to **government debt** remain limited. The debt ratio increased slightly to 73.3% of GDP in 2022 and is forecast to continue rising moderately. The government deficit declined to 0.8% of GDP in 2022 but is forecast to widen in 2023. Fiscal sustainability risks are medium both in the medium and long term ([102]).

Graph 4.26: **Selected graphs: Finland**



Source: AMECO, Eurostat and European Commission

([102]) Estimated based on the Commission's 2023 spring forecasts.

Table 4.26: **Key economic and financial indicators, Finland**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	forecast 2023	2024
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**-0.5**	**0.2**	**-0.5**	**-0.9**	**-1.1**
Current account balance, balance of payments (% of GDP)		-0.9 (1)	-0.1 (2)	0.5	0.4	-2.5	-0.5	-0.2
Net international investment position (% of GDP)	**-35%**	**-78.6 (3)**	**-2.7 (4)**	**-4.0**	**1.0**	**-1.7**	**-2.5**	**-2.9**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				5.8	18.3	6.3		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**5.5**	**6.2**	**8.6**	**13.3**	**11.9**
Nominal unit labour cost index (% y-o-y change)				0.9	3.2	4.2	5.3	2.0
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**2.3**	**-0.7**	**-3.1**	**-1.9**	**-2.5**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				1.6	-0.7	-3.9	1.3	-1.3
Export market share - % of world exports (5 year % change)	**-6%**			**10.9**	**3.8**	**-2.0**	**-3.8**	**-7.3**
Export market share - % of world exports (1 year % change)				0.5	-3.9	-1.9	-1.0	-1.2
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**152.7**	**150.5**	**144.7**	**138.5**	**135.8**
Private sector credit flow, consolidated (% of GDP)	**14%**			**6.5**	**6.1**	**2.3**	**1.6**	**1.4**
Household debt, consolidated (% of GDP)		49.9 (6)	60.4 (7)	69.0	67.9	65.3	62.1	
Non-financial corporate debt, consolidated (% of GDP)		62.6 (6)	83.8 (7)	83.7	82.6	79.4	76.4	
Housing market								
House price index, deflated (1 year % change)	**6%**			**1.4**	**2.8**	**-4.6**	**-8.0**	**-0.3**
House price index, nominal (1 year % change)		-3.6 (8)		1.8	4.6	1.2	-4.0	1.6
Government debt								
General government gross debt (% of GDP)	**60%**			**74.7**	**72.5**	**73.3**	**74.3**	**76.9**
General government balance (% of GDP)				-5.6	-2.8	-0.8	-2.4	-3.2
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**8.0**	**9.1**	**1.7**	**-2.3**	
Return on equity (%)				5.8	9.2	9.6		
Common Equity Tier 1 ratio		10.6 (9)		18.1	17.8	17.2		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				1.5e	1.2e	1.0p	1.0	
Labour market								
Unemployment rate (3 year average)	**10%**			**7.3**	**7.4**	**7.4**	**7.2**	**7.1**
Unemployment rate (year level)		6.5 (10)		7.7	7.7	6.8	7.2	7.3
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**1.5**	**1.8**	**2.5**	**3.1**	**1.9**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-1.1**	**-0.2**	**0.0**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**1.0**	**-0.2**	**-3.5**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

SWEDEN

In Sweden, concerns related to house prices, high household debt and corporate debt remain. Nominal house prices have fallen in recent quarters, but are still estimated to be overvalued. The household debt-to-GDP ratio is very high but is set to continue falling. The high share of mortgages with variable interest rates and long durations quickly transmits interest rate rises into the economy, weighing on households' finances and consumption. The downward correction of commercial real estate represents another source of risk to macroeconomic stability.

Real GDP growth reached 2.8% in 2022 and is forecast at -0.5% in 2023 and -0.2% in 2024. Headline inflation stood at 3.7% year-on-year in September 2023. This is below the peak of 10.8% recorded in December 2022 and below the EU and euro area averages. Core inflation also decreased, from a peak of 7.7% in July 2023, to 6.8% in September 2023, which is above the EU and euro area averages. Nominal wages per person grew less than prices in 2022 and are expected to also do so in 2023.

The scoreboard reading for Sweden shows that two indicators were beyond their indicative thresholds in 2022, namely private sector debt and the youth unemployment rate. Relevant developments worth highlighting:

- **Cost competitiveness** concerns remain limited. The Swedish krona has depreciated markedly against the euro in 2022 and so far in 2023, which has led to a significant depreciation of the HICP-based real effective exchange rate, while core inflation has exceeded the average rate in euro area trading partners. Nominal unit labour costs grew relatively little in 2022 and are expected to grow stronger in 2023, but on a par with the euro area partners and the rest of the EU. External sustainability concerns are limited and remain largely unchanged.

- The **non-financial corporate debt**-to-GDP ratio remains among the highest in the EU, although it recently decreased to 120% in 2022. This is still 9 percentage points higher than in 2019. It remained broadly unchanged in the first half of 2023. Credit flows decreased, but remain high, at 7.3% of GDP in 2022. The interest rate burden is high and increased recently. Commercial real estate is a particular source of concern given falling prices and its funding structure. Risks associated with corporate debt outside commercial real estate are mitigated by the high share of cross-border intra-group lending and increasing corporate liquidity buffers.

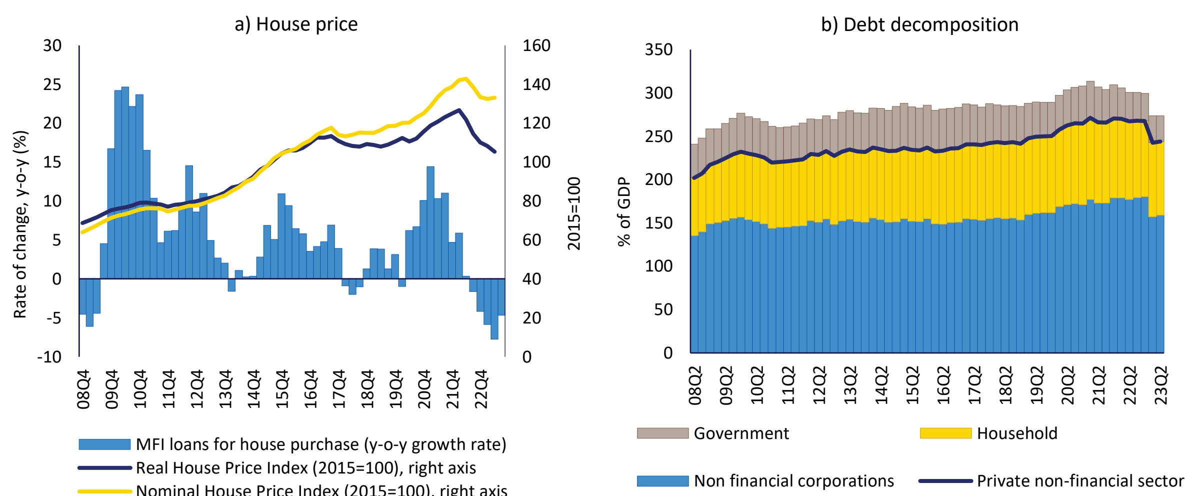
- The **household debt**-to-GDP ratio is very high, at 87% in 2022. Having doubled between 2000 and 2020, the ratio declined the following 2 years on the back of strong nominal output growth. This relative decline is set to continue in 2023, reflecting high inflation and a contraction in credit flows (from very high levels) triggered by a fourfold increase in interest rates. 87% of new mortgages have a variable interest rate, and mortgage maturities are very long while amortisation is low, resulting in a high interest component of mortgage costs. These two factors are putting pressure on household budgets, reducing household consumption and economic growth. Households' gross savings rate is high at 16% in 2022. Real wages are set to decline in 2023 and recover in 2024.

- **House prices** have fallen but concerns related to the housing market persist. After a peak in early 2022, house prices started to decline, ending the year 3% lower compared to the end of 2021. Transaction volumes declined sharply in 2022, falling by more than half and have remained at around this level, the lowest since 2014. These reduced transaction volumes likely distort the price signal of the average house price. However, despite the recent fall, house prices still appear to be overvalued by around 20-25% due to the strong growth in excess of

incomes over the last decade. In the future, the lower borrowing capacity of households on the back of higher interest rates is expected to further reduce house prices before long-standing supply constraints bite. The prevalence of long mortgage maturities and limited mortgage amortisation requirements increases the sensitivity of households' borrowing capacity to changes in interest rates.

- The **banking sector** remains healthy. The Common Equity Tier 1 capital ratio and profitability are close to the EU average, although profitability declined slightly in 2022. The non-performing loans ratio, 0.8% as of the first quarter of 2023, is among the lowest in the EU. Credit provision to both corporates and households was still very high in the first half of 2022 but declined significantly in late 2022. The ongoing correction of house prices represents a challenge for the financial sector as well as for households that are highly indebted, although mortgages have very long maturities. The high exposure of the financial sector to commercial real estate represents another source of risk.

Graph 4.27: **Selected graphs: Sweden**



Source: AMECO, Eurostat and European Commission

Table 4.27: **Key economic and financial indicators, Sweden**

	Thresholds	Benchmark I	Benchmark II	2020	2021	2022	forecast 2023	2024
External position								
Current account balance, balance of payments (% of GDP, 3-year average)	**-4%/6%**			**4.6**	**6.0**	**5.8**	**5.6**	**4.9**
Current account balance, balance of payments (% of GDP)		0.5 (1)	1.3 (2)	5.9	6.8	4.8	5.1	4.7
Net international investment position (% of GDP)	**-35%**	**-88.1 (3)**	**2.8 (4)**	**6.9**	**20.7**	**34.8**	**42.0**	**46.2**
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)				-12.6	-3.0	-9.8		
Competitiveness								
Nominal unit labour cost index (3 year % change)	**9% (EA) 12% (Non-EA)**			**8.7**	**4.6**	**5.8**	**8.5**	**13.0**
Nominal unit labour cost index (% y-o-y change)				3.4	-0.3	2.7	6.0	3.8
Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	**±5% (EA) ±11% (Non-EA)**			**-4.8**	**2.1**	**-1.4**	**-8.8**	**-13.0**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)				3.1	3.0	-7.1	-3.8	-1.8
Export market share - % of world exports (5 year % change)	**-6%**			**2.8**	**0.9**	**-2.7**	**-0.3**	**-6.1**
Export market share - % of world exports (1 year % change)				4.0	-1.0	-6.0	0.2	-3.3
Private sector debt								
Private sector debt, consolidated (% of GDP)	**133%**			**212.7**	**214.5**	**207.3**	**199.6**	**199.2**
Private sector credit flow, consolidated (% of GDP)	**14%**			**14.5**	**17.1**	**10.6**	**5.7**	**4.3**
Household debt, consolidated (% of GDP)		54.2 (6)	67.9 (7)	93.7	91.9	87.4	82.8	
Non-financial corporate debt, consolidated (% of GDP)		65.4 (6)	60.8 (7)	119.0	122.6	119.9	116.8	
Housing market								
House price index, deflated (1 year % change)	**6%**			**3.3**	**8.1**	**-3.1**	**-16.2**	**-2.9**
House price index, nominal (1 year % change)		29.2 (8)		4.2	10.1	3.6	-9.5	0.0
Government debt								
General government gross debt (% of GDP)	**60%**			**39.9**	**36.5**	**32.9**	**30.4**	**30.1**
General government balance (% of GDP)				-2.8	0.0	1.1	-0.2	-0.7
Banking sector								
Total financial sector liabilities, non-consolidated (1 year % change)	**16.5%**			**10.4**	**11.2**	**3.7**	**0.0**	
Return on equity (%)				8.4	10.0	9.8		
Common Equity Tier 1 ratio		10.6 (9)		19.2	19.2	18.9		
Gross non-performing loans, domestic and foreign entities (% of gross loans)				1.0e	1.0e	0.8p	0.8	
Labour market								
Unemployment rate (3 year average)	**10%**			**7.3 b**	**8.1**	**8.3**	**8.0**	**7.9**
Unemployment rate (year level)		6.8 (10)		8.5	8.8	7.5	7.6	8.5
Activity rate - % of population aged 15-64 (3 year change in pp)	**-0.2 pp**			**0.0**	**0.6 b**	**1.0**	**2.4**	**1.5**
Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	**0.5 pp**			**-0.2**	**0.3**	**0.4**		
Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)	**2 pp**			**6.3**	**7.9**	**2.3**		

Notes: See Annex 1

Source: Eurostat and ECB as of 31.10.2023, where available; European Commission for forecast figures (Autumn forecast 2023)

EURO AREA

In the euro area, the current account surplus turned to deficit as a result of the terms of trade shock in 2022, but has since moved back into surplus. Competitiveness concerns remain limited overall although lasting differentials in price and cost developments between euro area members can raise challenges. Debt ratios, which remain high, are on a declining path, while house prices have been moderating, but the risk of an abrupt correction is limited at the euro area level.

Real GDP growth in the euro area reached 3.4% in 2022 and is forecast at 0.6% in 2023 and 1.2% in 2024. Headline inflation decreased to 2.9% in October 2023. This is below the peak of 10.6% recorded in October 2022. Core inflation also decreased, from a peak of 5.7% in March 2023, to 4.2% in October 2023. Nominal wages per person grew less than prices in 2022 and are expected to grow broadly in line with prices in 2023.

Relevant developments worth highlighting:

- **External sustainability** concerns remain limited for the euro area as a whole. In 2022, the current account balance fell into a deficit (-0.6% of GDP), for the first time in more than a decade. This decline was due to the negative terms of trade shock stemming mainly from much higher energy prices. The current account balance in the euro area returned to a small surplus in the second quarter of 2023 and is expected to continue increasing this year and next. The net international investment position (NIIP) of the euro area increased slightly to 3.2% of GDP in 2022, and is set to continue trending upward. The NIIP net of non-defaultable instruments has been improving and reached -25% of GDP in 2022.

- **Cost competitiveness** concerns remain limited for the euro area. As higher inflation and labour costs have also been a feature for trading partners, the relative positions of the euro area and the EU were not affected that much. The nominal depreciation of the euro helped EU competitiveness vis-à-vis the rest of the world in 2022. The nominal appreciation of the euro and some other EU currencies in late 2022 and in most of 2023 has partially undone earlier depreciations, with some of the other EU currencies having appreciated somewhat against the euro. Yet lasting differentials in prices, wages, and unit labour costs across the various euro area members, especially when not underpinned by the fundamentals of their economies, can raise a number of challenges.

- The euro area aggregate **non-financial corporate debt**-to-GDP ratio declined by 5 percentage points, reaching 80% at the end of 2022, close to its level before the COVID-19 pandemic. It continued decreasing in the first half of 2023, amid strong nominal GDP growth and weakening credit flows. Tightening financing conditions, and an increase in bankruptcies were mitigated by a sharp increase in unit profits, but these started to decrease in early 2023. The energy crisis and tighter financial conditions could increase insolvencies and corporate vulnerabilities and weigh on corporate investment, fuelling competitiveness and growth differentials in the euro area.

- The euro area aggregate **household debt**-to-GDP ratio peaked at 61% in 2020 and fell to 56% by 2022 on the back of high inflation and significant real GDP growth. It is expected to continue decreasing in 2023. As a share of adjusted disposable income, the household debt decreased from 96% in 2021 to 90% by the second half of 2023. Net credit flows in the euro area peaked between mid-2021 and mid-2022, and then dropped significantly in 2023 as a

result of soaring interest rates. Aggregate savings remain robust but may vary along the income distribution.

- After a sharp increase in **house prices** in 2022, house prices started to moderate in most countries. On aggregate in the euro area, nominal house prices grew by 7.1% in 2022, building on years of increases above income. Nominal house price growth has moderated substantially in recent quarters and turned negative in the second quarter of 2023. House prices are overvalued in a number of countries, but the risk of an abrupt correction is limited at euro area level.

- The euro area **financial sector** on aggregate remains sound. The Common Equity Tier 1 capital ratio marginally declined, whereas profitability increased in 2022 and the non-performing loans ratio remained low. Credit dynamics have slowed down since mid-2022 alongside a tightening of financial conditions. The resilience of the banking sector has continued into 2023, with a significant increase in profitability in the first half of the year and a recovery of capital ratios. Financing conditions for the private sector remain tight and credit growth very muted.

- Euro area aggregate **government debt** decreased by nearly 4 percentage points to 91% of GDP in 2022 and is forecast to decline further. The average government deficit in the euro area improved in 2022 and reached 3.6% of GDP. The government balance is expected to further improve this year and next.

Table A1.1: **Notes to the tables of the Country sections**

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

(1) Current accounts in line with fundamentals (current account norms): derived from reduced form regressions capturing the main determinant of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See L. Coutinho et al. (2018), "Methodologies for the assessement of current account benchmarks", European Economy, Discussion Paper 86/2018.

(2) Current account required to stabilise the NIIP above -35% of GDP over 20 years: Calculations make use of Commission's T+10 projections. See L. Coutinho et al. (2018), "Methodlogies for the assemsent of current account benchmarks", European Economy, Discussion Paper 86/2018.

(3) Prudential NIIP/NENDI benchmark: the prudential threshold for NIIP is the country-specific level beyond which estimates suggest that a BoP crisis is more likely. Turrini A. and S. Zeugner (2019) Benchmarks for Net International Investment Positions, European Economy, Discussion Paper 097/ May 2019.

(4) Fundamentally explained NIIP benchmark (NIIP norm): NIIP achieved if a country had run a current account balance in line with fundamentals since 1994. It thus represents the part of the NIIP that can be explained by fundamentals. Turrini A. and S. Zeugner (2019) Benchmarks for Net International Investment Positions, European Economy, Discussion Paper 097/ May 2019.

(5) NIIP net of non-defaultable instruments (NENDI): subset of the NIIP that abstracts from its pure equity-related components, i.e. foreign direct investment (FDI) equity and equity shares, and from intracompany cross-border FDI debt. It represents the NIIP excluding instruments that cannot be subject to default. Turrini A. and S. Zeugner (2019) Benchmarks for Net International Investment Positions, European Economy, Discussion Paper 097/ May 2019.

(6) Prudential threshold for non-financial corporate and household debt to GDP ratio: corresponds to the level above which the risk of crisis becomes elevated. It is derived from regressions minimising the probability of missed crisis and that of false alerts. Bricongne, J. C., Coutinho, L., Turrini, A., Zeugner, S. (2019), "Is Private Debt Excessive?", Open Economies Review, 1- 42.

(7) Fundamentals-based benchmarks for non-financial corporate and household debt to GDP ratios: assesses private debt from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. Bricongne, J. C., Coutinho, L., Turrini, A.,Zeugner, S. (2019), "Is Private Debt Excessive?", Open Economies Review, 1- 42.

(8) Average house price gap: is the simple average of the price-to income, price-to rent and model valuation gaps. The model valuation gap is estimated in a cointegration framework using a system of five fundamental variables: total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure. Based on Philiponnet, N., Turrini, A. (2017), "Assessing House Price Developments in the EU," European Economy - Discussion Papers 2015 - 048, Directorate General Economic and Financial Affairs (DG ECFIN), European Commission.

(9) Common equity Tier 1 ratio required by the ECB in the 2021 Supervisory Review and Evaluation Process.

Source: European Commission

Table 1.1: MIP Scoreboard 2022

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

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

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

Table 2.1: Auxiliary indicators, 2022

2022	Real GDP (1 year % change)	Gross fixed capital formation (% of GDP)	Gross domestic expenditure on R&D (1 year % change)	Current plus capital account (Net lending-borrowing) (% of GDP)	Net international investment position excluding non-defaultable instruments (% of GDP)	Direct investment liabilities - flows (% of GDP)	Direct investment liabilities - stocks (% of GDP)	Net trade balance of energy products (% of GDP)	Real effective exchange rate - euro area trading partners (3 year % change)	Export performance against advanced economies (5 year % change)	Terms of trade (5 year % change)	Export market share in volume (1 year % change)	Labour productivity (1 year % change)	Gross non-performing loans of domestic and foreign entities (% of gross loans)	Unit labour cost performance relative to EA (10 year % change)	House price index (2015=100) - nominal (3 year % change)	Residential construction (% of GDP)	Household debt, consolidated (incl. NPISH, % of GDP)	Consolidated banking leverage, domestic and foreign entities (total assets/total equity)
EU	3.4	22.5	na	0.2	-20.5e	-1.8	64.5	-4.1	na	-2.6	-4.3	2.5	1.4	1.8p	na	23.2	5.9	54.8p	14.6p
EA	3.4	22.4	na	0.6	-25.8	-2.3	74.5	-4.4	na	-3.9	-5.0	2.3	1.1	1.8p	na	21.6	6.3	56.1p	14.7p
BE	3.0p	23.9p	3.4p	-0.8	28.8	2.0	153.6	-4.1p	2.1	1.8	-4.3p	0.0p	0.9p	1.5p	-1.5	17.9	6.0p	60.0p	14.2p
BG	3.9	17.1	0.8p	-0.5	44.4	3.6	68.4	-4.1	4.9	19.8	8.2	6.7	4.3	3.7p	63.8	29.3b	2.8	22.5	8.8p
CZ	2.4	26.8	2.0p	-6.0	28.4	3.6	76.7	-4.7	13.7	-4.2	-1.9	2.3	0.8	1.4p	12.8	51.7	4.3	32.6	13.0p
DK	2.7	21.7	na	13.5	34.9	8.6	59.2	-1.0	-0.9	16.6	4.1	5.9	-1.0	1.5p	-4.6	16.9	5.2	84.8	16.4p
DE	1.8p	22.1p	3.1p	3.7	49.8	1.1	48.8	-3.4p	0.3	-9.7	-5.9p	-1.6p	0.4p	1.1p	9.5	26.6	7.3p	55.0p	14.3p
EE	-0.5	27.5	na	-2.9	28.7	4.7	118.3	-2.3	9.5	21.4	3.6	-1.9	-4.8	0.8p	36.8	49.1	5.1	36.8	9.0p
IE	9.4	21.6	1.0e	10.6	-234.0	-0.1	366.8	-2.2	-2.0	37.1	-1.3	9.0	2.6	1.7p	-38.3	22.0	2.4	25.5	9.3p
EL	5.6p	13.7p	na	-8.8	-120.7	3.6	25.2	-6.0p	-3.1	16.9	-4.2p	1.3p	3.0p	6.2p	-23.0	24.9e	1.6p	45.2p	15.0p
ES	5.8p	20.1p	na	1.5	-30.2	3.6	75.4	-3.9p	-0.5	-4.3	-6.4p	10.3p	3.0p	2.7p	-4.3	13.8	5.7p	52.3p	16.0p
FR	2.5p	25.2p	2.1p	-1.6	-33.4	3.8	51.6	-4.3p	-3.6	-7.3	-2.6p	2.2p	-0.2p	1.8p	-2.5	18.9	7.1p	66.2p	16.0p
HR	6.3p	19.6p	1.4	-0.3	13.5	5.0	53.9	-9.0p	-0.4	16.3	-7.0p	22.1p	3.9p	3.0p	-11.0	32.7	3.4p	30.7p	9.0p
IT	3.7	21.9	1.3p	-0.9	1.6	3.0	31.3	-5.6	-1.4	-5.0	-9.5	5.0	2.0	2.9p	-5.8	8.5	6.5	40.9	13.7p
CY	5.1p	20.4p	na	-7.7	39.9	3.4	1509.8	-6.6p	-2.5	25.3	-1.6p	8.7p	2.0p	4.5p	-18.0	-0.5	8.6p	71.7p	17.0p
LV	3.4	21.7	0.7	-4.0	16.9	2.9	61.0	-7.2	6.1	19.6	2.3	5.4	0.6	1.4p	33.0	30.6	2.4	17.7	10.2p
LT	2.4	21.4	1.0	-4.0	21.2	0.9	48.3	-10.5	11.0	33.6	-11.3	7.3	-2.5	0.9p	44.8	48.2	3.6	21.8	17.1p
LU	1.4	17.5	na	7.9	-3753.7	-568.7	5083.0	-4.6	-0.2	3.0	0.7	-5.5	-1.9	1.2p	17.4	42.9	3.7	66.8	15.2p
HU	4.6p	28.2p	1.4	-6.2	-5.3	-5.4	293.4	-9.9p	-7.5	0.1	-7.2p	7.7p	3.0p	3.1p	20.0	49.5p	4.7p	18.6p	11.4p
MT	6.9	25.3p	0.7	-1.5	111.8	127.7	2679.8	-8.1	-3.9	6.5	0.5	1.9	0.7	2.3p	11.7	15.9p	4.3p	55.7	12.6p
NL	4.3p	20.9p	na	20.3	18.5	-1.7	516.2	-1.2p	3.8	3.7	-2.7p	-0.4p	0.4p	1.3p	0.5	40.5	5.4p	92.4p	15.9p
AT	4.8	25.3	3.2p	-0.2	-1.5	2.1	57.2	-4.4	0.7	-1.2	-4.5	6.3	2.1	1.8p	5.1	34.9	5.6	48.7	11.1p
PL	5.3	16.8	1.5p	-1.9	2.7	5.3	46.0	-3.4	0.5	21.0	-2.6	1.8	4.8p	4.3p	8.2	34.8	2.2	26.6	13.5p
PT	6.8p	20.1p	1.7p	-0.2	-29.6	3.8	80.3	-4.8p	-2.5	1.8	-3.0p	12.5p	5.2p	3.0p	4.4	34.0	3.9p	60.7p	12.3p
RO	4.6p	24.9p	0.5	-6.7	-4.2	3.8	42.2	-2.8p	2.3	10.7	3.9p	4.7p	3.4p	2.8p	33.1	17.1	2.7p	13.9p	11.2p
SI	2.5	21.6	na	-1.4	15.2	3.6	43.2	-3.8	-1.0	6.8	-4.0	2.3	-0.4	1.8p	1.7	33.9	2.8	25.9	10.0p
SK	1.8	20.1	1.0	-6.2	-18.2	3.5	62.0	-6.6	4.7	-3.1	-5.9	-1.9	0.0	1.7p	14.2	32.5	4.3	47.1	10.7p
FI	1.6	24.2	3.0	-2.5	6.3	4.8	51.0	-3.5	-2.7	1.7	1.1	-1.2	-1.3	1.0p	-7.1	7.7	7.2	65.3	17.4p
SE	2.8	27.1	3.4	4.9	-9.8	9.0	95.6	-1.2	-1.1	0.9	-2.4	2.1	0.1	0.8p	1.4	18.8	5.4	87.4	16.3p

Flags:b:Break in series. e:Estimated. p:Provisional.

1) House price index: b = break in time series due to new data source for BG; e = estimate by NCB for EL.
Source: European Commission, Eurostat and Directorate General for Economic and Financial Affairs (for Real Effective Exchange Rate), European Central Bank (for Consolidated banking leverage and Gross non-performing loans, domestic and foreign entities), and International Monetary Fund data, WEO (for world volume exports of goods and services)

Table 2.1 (continued): Auxiliary indicators, 2022

2022	Employment (1 year % change)	Activity rate - % of total population aged 15-64 (%)	Long-term unemployment rate - % of active population aged 15-74 (%)	Youth unemployment rate - % of active population aged 15-24 (%)	Young people neither in employment nor in education and training - % of total population aged 15-24		People at risk of poverty or social exclusion - % of total population		People at risk of poverty after social transfers - % of total population		Severely materially and socially deprived people - % of total population		People living in households with very low work intensity - % of total population aged 0-64	
					%	3 year change in pp	%	3 year change in pp	%	3 year change in pp	%	3 year change in pp	%	3 year change in pp
EU	2.0	74.5	2.4	14.5	9.6	-0.9	21.6	0.5	16.5	0.0	6.7	0.0	8.3	0.3
EA	2.3	74.5	2.7	14.6	9.5	-1.0	21.8	1.1	16.8	0.4	6.1	0.3	9.1	0.4
BE	2.1p	70.5	2.3	16.4	6.6	-2.0	18.7	-1.3b	13.2	-1.6b	5.8	-0.5	11.5	-1.3
BG	-0.3	73.6	2.3	10.7	12.5	-1.1	32.2	-1.0	22.9	0.3	18.7	-3.4	8.6	-0.6
CZ	1.5	77.2	0.6	6.8	8.0	2.3	11.8	-0.3	10.2	0.1	2.1	0.0	4.5	0.1
DK	3.8	80.4	0.5	10.6	6.7	-1.0	17.1	-0.2	12.4	-0.1	3.2	-0.6	8.8	-0.7
DE	1.4p	79.4	1.0	6.0	6.8	0.4	20.9	3.6	14.7	-0.1	6.1	3.1	9.7	2.1
EE	4.6	81.2	1.3	18.6	10.7	3.0	25.2	1.5	22.8	1.1	3.3	0.7	5.7	0.4
IE	6.6	76.7	1.3	10.1	6.8	-3.3	20.7	0.3	14.0	0.9	5.8	-1.3	10.5	-3.3
EL	2.5p	69.4	7.7	31.4	10.6	-0.2	26.3	-2.7	18.8	0.9	13.9	-1.9	9.5	-3.2
ES	2.7p	74.0d	5.0d	29.8d	10.5d	-1.6d	26.0	-0.2	20.4	-0.3	7.7	0.0	8.7	-2.2
FR	2.6p	73.6d	2.0d	17.3d	10.1d	-0.4d	21.0b	2.2b	15.6b	2.0b	7.7b	0.4b	9.9b	2.8b
HR	2.3	69.9	2.4	18.0	11.9	0.1	19.9	-0.9	18.0	-0.3	4.0	-0.6	6.3	-1.2
IT	1.7	65.5	4.6	23.7	15.9	-3.1	24.4	-0.2	20.1	0.0	4.5	-1.9	9.8	0.2
CY	3.0p	78.2	2.3	18.6	12.9	-0.8	16.7	-1.9	13.9	-0.8	2.7	-0.5	4.1	-2.5
LV	2.7	76.8	2.0	15.3	8.6	0.7	26.0	-0.7	22.5	-0.4	7.8	0.3	7.2	-0.2
LT	5.1	78.6	2.3	11.9	9.7	1.1	24.6	-0.9	20.9	0.3	6.0	-3.7	8.3	0.7
LU	3.4	73.5	1.3	17.6	6.7	1.1	19.4b	-0.7b	17.4b	-0.1b	2.0b	0.6b	3.5b	-3.4b
HU	1.5p	77.2	1.2	10.6	9.9	-0.6	18.4	-1.6	12.1	-0.2	9.1	-1.8	6.2	1.3
MT	6.2	80.0	1.0	8.3	7.1	-1.5	20.1	-0.6	16.7	-0.4	4.9	-0.1	3.8	-1.1
NL	3.9p	84.7	0.7	7.6	2.8	-2.7	16.5	0.0	14.5	1.3	2.5	-0.3	8.4	-0.5
AT	2.6	77.8	1.2	9.5	8.1	0.3	17.5	1.0	14.8	1.5	2.3	-0.4	5.7	-0.9
PL	0.4p	73.5	0.9	10.8	8.0	-0.2	15.9	-2.0	13.7	-1.7	2.8	-0.7	3.8	-1.2
PT	1.5p	76.4	2.7	19.0	6.6	-1.4	20.1	-1.0	16.4	-0.8	5.3	-0.3	5.6	-0.6
RO	1.2p	66.8	2.2	22.8	17.5	-0.9	34.4	-1.7	21.2	-2.6	24.3	-0.2	4.2	-0.3
SI	2.9	76.2	1.6	10.1	8.2	1.9	13.3	-0.4	12.1	0.1	1.4	-0.8	3.8	-0.5
SK	1.8	76.1	4.1	19.9	9.6	-0.8	16.5	1.7	13.7	1.8	6.3	0.4	3.8	-2.5
FI	2.9	79.8	1.5	14.2	7.6	0.1	16.3b	1.8b	12.7	1.1	1.9	0.0	10.1b	2.0b
SE	2.7	83.5	1.9	21.7	4.9	-0.4	18.6	0.2	16.0	-1.1	2.3	0.8	8.2	-0.1

Flags:b:Break in series. d:Definition differs. p:Provisional.

1) Employment indicators: d = Spain and France have assessed the attachment to the job and included in employment those who had an unknown duration of absence from work, but are expected to return to the same job once COVID-19 health measures allow it. 2) Income and Living Conditions: b = for FR, inclusion of four overseas departments (French Guiana, Réunion, Martinique and Guadeloupe) in the SILC exercise; for LU, introduction of a CAPI component for the newly selected households; for FI, disruption of the registers' use for the definition of persons permanently disable or/and unable to work.
Source: European Commission, Eurostat

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