DIPARTIMENTO DEL
TESORO

Meccanismi di *early warning* per la sorveglianza macroeconomica

Conferenza Nazionale di Statistica

Roma, 20 Febbraio 2013

Lorenzo Codogno
MINISTERO DELL'ECONOMIA E DELLE FINANZE

Need for a new macroeconomic governance

- The economic crisis revealed that current account imbalances and divergences in price competitiveness among EU countries can endanger the EU and, more importantly, the EMU.
- Surveillance on macroeconomic imbalances needed to **go beyond the multilateral approach** of the Broad Economic Policy Guidelines.
- **Surveillance** must rely on an **early warning mechanism** to ensure that **necessary policy actions can be taken in due time,** and followed by **enforcement**.

New macroeconomic surveillance: how does it works?

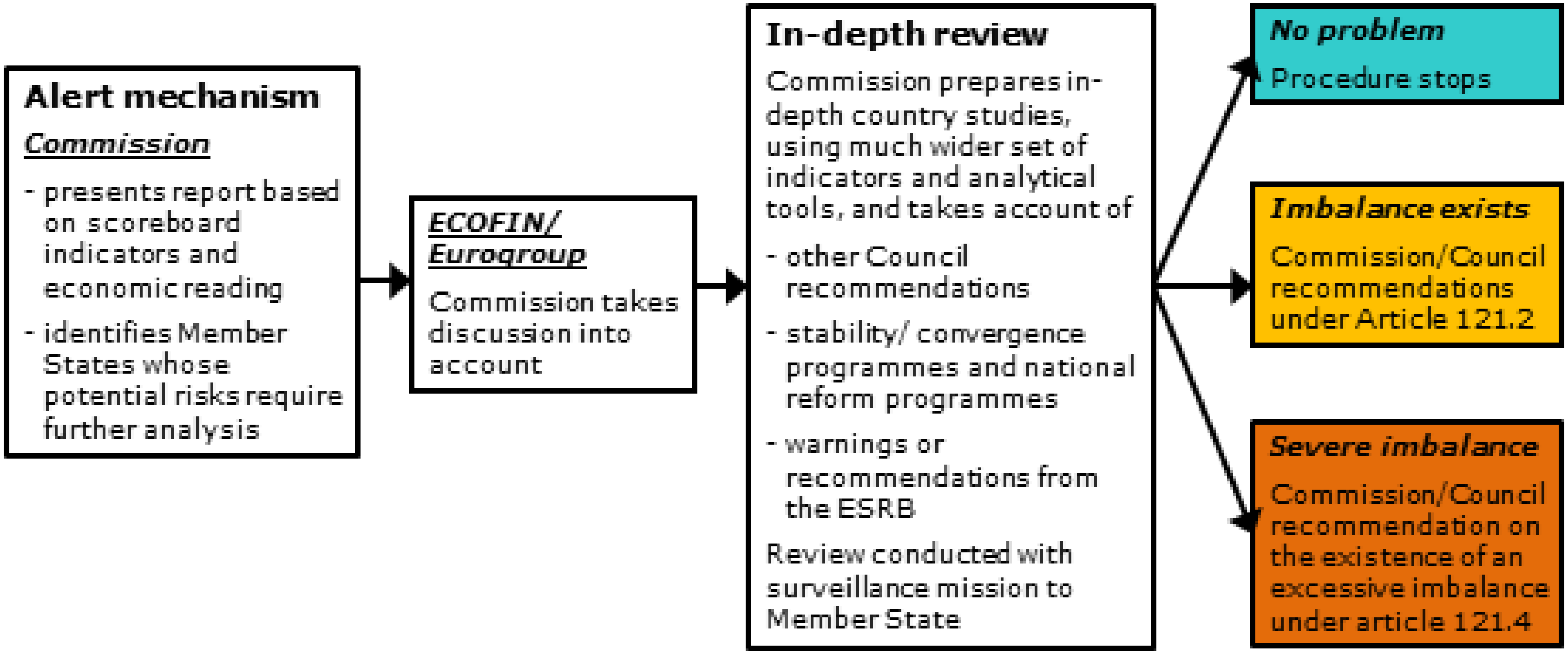
- **Macroeconomic Imbalances Procedure (MIP): identification of potential risks early on**, preventing the emergence of harmful imbalances and correcting the imbalances that are already in place.
- The objective is to **ensure that appropriate policy responses are adopted in MSs** in a timely manner. The new procedure is an integral part of the "European Semester".
- **The MIP is based on a graduated approach that reflects the gravity of imbalances:** a preventive arm may be followed by a corrective arm in case of severe imbalances.

The preventive arm of the MIP

- The first step is based on the **Alert Mechanism** which works as a **filter or a screening device** to identify countries with potentially harmful risks.
- In the second step these countries are put under **In-Depth Review (IDR)** so as to assess their vulnerability. An IDR does not automatically lead to recommendations, i.e. the corrective arm.

A TWO-STEP PROCEDURE

The preventive arm of the MIP



The corrective arm of the MIP

- **In case the IDR points to severe imbalances in a MS**, the Council declares the existence of an excessive imbalance and adopts recommendations asking the MS to present appropriate actions in a “corrective action plan”.
- Under the **Excessive Imbalance Procedure**, Euro Area MSs can be imposed **a fine of up to 0.1% of GDP if they fail twice to submit a sufficient corrective action plan.**
- Sanctions are decided by reverse qualified majority voting.

The first step of the MIP – The Alert Mechanism Report

- **Alert Mechanism Report (AMR):** indicator-based **Scoreboard** complemented by economic reading.
- **The results of the Scoreboard are not mechanically interpreted.** Other relevant information and additional economic indicators can also be taken into account. On this basis, **the Commission decides for which country an IDR is necessary**.
- AMR conclusions are discussed by the Council and the Eurogroup enabling the Commission to get appropriate feedback from MSs.

The Scoreboard

- **The Scoreboard is** a **signalling device** for potentially harmful imbalances **at an early stage** of their emergence, **made up of 11 indicators** and for each indicator an alert threshold is set.
- **The most relevant dimensions of internal and external macroeconomic imbalances** and competitiveness losses are included, with a particular focus on the smooth functioning of the Euro Area.
- An important **communication role**.
- **Indicators should be of high statistical quality** in terms of timeliness and comparability across countries.

External imbalances and competitiveness

- 3y average of the **current account balance** as a % of GDP, with +6% and - 4% thresholds.
- **Net International Investment Position** (NIIP) as a % of GDP, with a threshold of -35%.
- 5y percentage change of **export market shares** measured in values, with a threshold of -6%.

External imbalances and competitiveness

- 3y % change in nominal **unit labour cost**, with thresholds of +9% for Euro Area and +12% for non-Euro Area countries.
- 3y % change of the **real effective exchange rates** (REER) based on HICP deflators, relative to 35 other industrial countries, with thresholds of -/+5% for Euro Area countries and -/+11% for non Euro Area countries.

Internal imbalances

- **Private sector debt** as a % of GDP, 160% threshold.
- **Private sector credit flow** as a % of GDP, 15% threshold.
- Yoy changes in deflated **house price index**, 6% threshold.
- **General government sector debt** as a % of GDP, 60% threshold.
- 3y average of **unemployment rate**, 10% threshold.
- **Growth rate of financial sector liabilities**, 16.5% threshold.

Main issues related to the Scoreboard indicators

- **Basic statistical information**, **econometric modelling approaches** and **expert views** are crucial ingredients to identify whether imbalances are harmful or not.
- **Need to invest in a range of complementary tools** that can provide a comprehensive analysis of macroeconomic imbalances.
- **The availability of data** is still an issue for a number of indicators.

Main issues related to the Scoreboard indicators

- Need to distinguish between harmful and harmless developments depending on country-specific circumstances. Different thresholds have been set for catching up countries.
- Differentiating between positive supply side shocks and excessive demand shocks would be important, but cannot be achieved with a **limited number of indicators and statistical thresholds.** The economic reading of the scoreboard and the in-depth study play a crucial role in making such differentiations.

Main issues on indicators of internal imbalances

- The main challenge is to improve efforts towards **better coverage and quality of data**.
- **Private sector balance sheet:** differences in consolidation practices across countries hamper data comparability; quarterly data provided by the ECB useful to complement Eurostat's annual data are either confidential or unavailable for non-Euro Area countries.

Main issues on indicators of internal imbalances

- **House price index:** availability of harmonised nominal data for all EU MSs only since 2005.
- **Long time series** for most Eastern European countries are not readily available.
- Future analysis would need to be extended to **commercial property prices** and **regional house price developments**.

Main issues on indicators of external imbalances

- **Need for a comprehensive approach to assess imbalances:** it should be relatively simple and informative at the same time.
- The understanding of spillovers of macroeconomic imbalances across countries is of crucial importance.
- **Current accounts (CA): spillover effects across countries not explicitly quantified.** There is still a debate on how to consider the CA surplus and its negative spillover effects.

The case of Italy

TABLE II.6: MACROECONOMIC IMBALANCES REGISTERED PER COUNTRY

		Countries with imbalance
External imbalances	Current account balance	EL, ES, CY, LU, MT, PT, SK, BG, PL, RO, SE
	Net international investment position	EE, IE, EL, ES, CY, PT, SL, SK, BG, CZ, LV, LT, HU, PL, RO
	Real effective exchange rate (REER)	IE, SK, CZ, UK
	Export market share	BE, DE, IE, EL, ES, FR, IT, CY, NL, AT, PT, FI, DK, SE, UK
	Nominal ULC	EL, LU, SL, SK, FI, BG, PL, RO
Internal imbalances	House price index	FI, SE
	Private credit flow	CY
	Private debt	BE, EE, IE, ES, CY, LU, MT, NL, AT, PT, FI, BG, DK, SE, UK
	Public debt	BE, DE, IE, EL, ES, FR, IT, CY, MT, NL, AT, PT, HU, UK
	Unemployment rate	EE, IE, ES, PT, SK, LV, LT

Source: Alert Mechanism Report, published on 14/02/2012 by the European Commission.

- With only two indicators above the thresholds Italy was put under the preventive arm of the procedure in 2012.

The future of the MIP

- **Enhancing transparency and robustness of the assessment** frameworks is of paramount importance.
- Additional work should be done to assess the **appropriateness of the current Scoreboard.**
- **Technical debate on effective policy responses** to each macroeconomic imbalances should be strengthened.

No major imbalances (apart from high public debt)

- **No major macroeconomic imbalances**: no major bubbles in the housing market, low household debt, fundamentally sound banking system, no major external imbalances.
- **No increase in discretionary spending during the crisis**: prudent fiscal policy; automatic stabilisers allowed to work.
- **Competitiveness issues** are contained; although admittedly high **public debt/GDP** is a major hurdle.

No major macroeconomic imbalances

	External imbalances					Internal imbalances					
	Current account	Net international investment position	REER	Export market share	Nominal ULC	House price index	Private credit flow	Private debt	Public Debt	Unemployment rate	Financial sector total non-consolidated liabilities
	3 year		on CPI	5 year	3 year	Year/year				3 year level	Year/year
	variation			variation	variation	Variation					variation
	% GDP	% GDP	% GDP				% GDP	% GDP	% GDP		
	-4/+6%	-35%	+/-5 (EA); +/-11% (Non EA)	-6%	+9 (EA); +12% (Non EA)	6%	15%	160%	60%	10%	16.5%
BE	-0.3	65.7	-0.5	-10.2	6.2	-0.1	11.6	236.0	98.0	7.8	4.7
DE	5.9	32.6	-3.9	-8.4	5.9	1.4	4.8	128.0	81.0	6.9	2.1
IE	0.0	-96.0	-9.1	-12.2	-12.8	-15.2	4.0	310.0	106.0	13.3	-0.6
EL	-10.4	-86.1	3.1	-18.7	4.1	-5.1	-5.5	125.0	171.0	13.2	-3.4
ES	-4.3	-91.7	-1.3	-7.6	-2.1	-10.0	-4.1	218.0	69.0	19.9	3.7
FR	-1.6	-15.9	-3.2	-11.2	6.0	3.8	4.0	160.0	86.0	9.6	7.3
IT	**-2.9**	**-20.6**	**-2.1**	**-18.4**	**4.4**	**-2.0**	**2.6**	**129.0**	**121.0**	**8.2**	**3.8**
LU	7.5	107.8	0.8	-10.1	12.5	1.5	2.5	326.0	18.0	4.8	11.3
NL	7.5	35.5	-1.6	-8.2	5.8	-4.0	0.7	225.0	66.0	4.2	7.2
AT	2.2	-2.3	-1.0	-12.7	5.9	-8.0	4.1	161.0	72.0	4.4	-0.3
PT	-9.1	-105.0	-1.9	-9.5	0.9	-3.6	-3.2	249.0	108.0	11.9	-0.7
FI	0.6	13.1	-1.3	-22.9	9.1	-0.3	4.6	179.0	49.0	8.1	30.8
DK	5.0	24.5	-1.7	-16.9	4.7	-4.9	-2.2	238.0	47.0	7.0	4.7
SE	6.6	-8.3	3.9	-11.6	1.2	1.0	6.3	232.0	38.0	8.1	3.6
UK	-2.2	-17.3	-7.1	-24.2	8.1	-5.4	1.0	205.0	85.0	7.8	8.5

Source: MEF elaboration on Alert Mechanism Report 2013 (European Commission, November 2012)

Dipartimento del TESORO

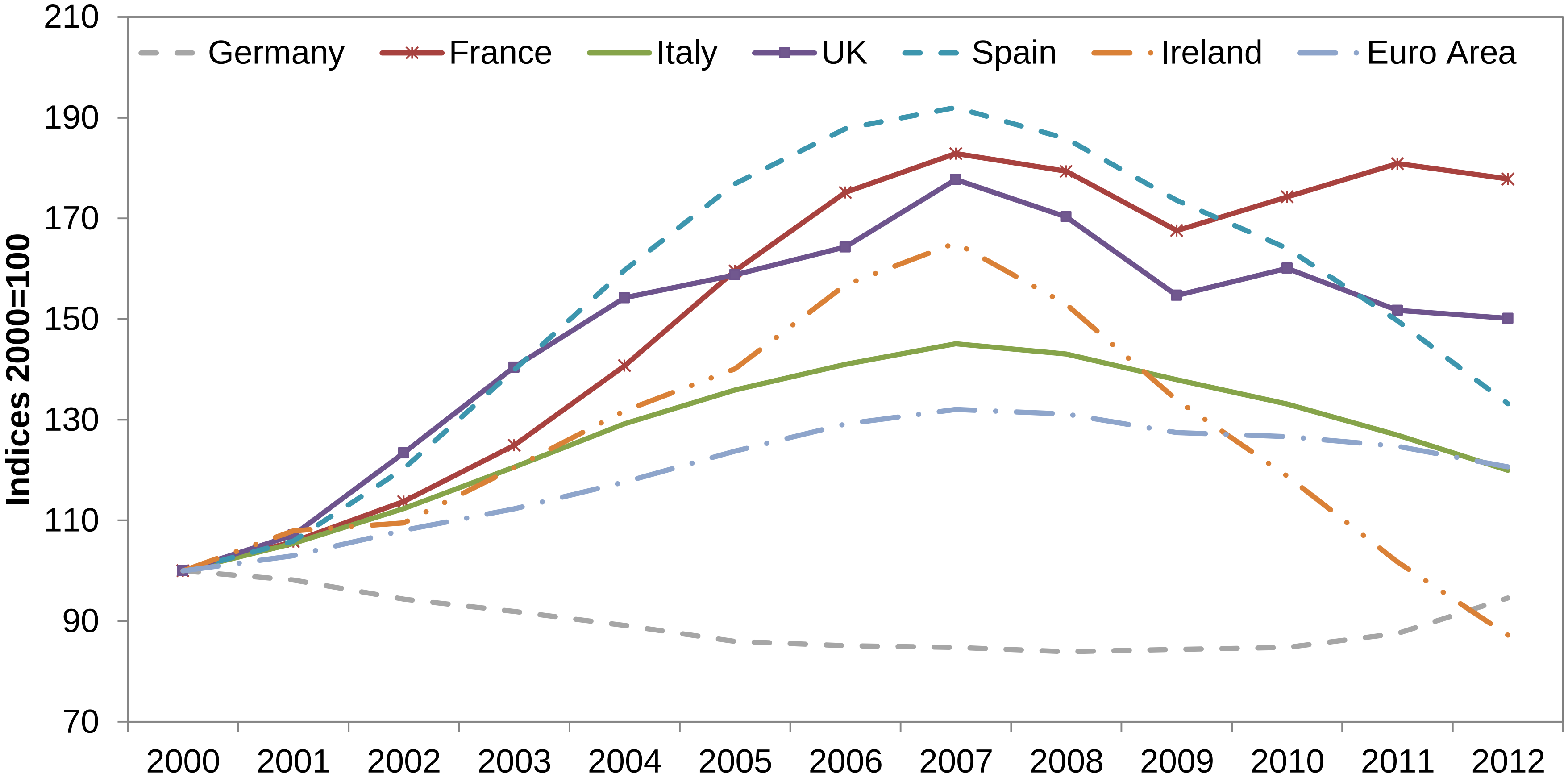
Ministero dell'Economia e delle Finanze

Modest deterioration in competitiveness over time

	Current account	Net international investment position	REER	Export market share	ULC	House price index	Private credit flow	Private debt	Public debt	Unemployment rate	Financial sector liabilities
2001	0.4	-5.8	-5.7	-18.5	4.8	5.4	8.4	87.0	108.0	10.0	-3.0
2002	-0.1	-12.4	-2.0	-14.2	7.0	6.5	6.4	90.0	105.0	9.2	3.9
2003	-0.3	-13.6	8.8	-13.4	10.7	7.4	7.0	93.0	104.0	8.6	11.6
2004	-0.5	-15.8	9.9	-7.4	9.8	7.1	8.3	98.0	103.0	8.3	7.2
2005	-0.7	-16.8	6.9	-5.2	8.7	5.2	9.4	104.0	106.0	8.1	12.1
2006	-0.9	-22.2	1.1	-12.5	6.5	3.2	10.9	110.0	106.0	7.5	10.5
2007	-1.2	-24.5	0.7	-9.3	6.1	2.6	13.1	118.0	103.0	6.9	0.5
2008	-1.9	-24.1	3.2	-16.3	8.3	-0.4	6.7	122.0	106.0	6.5	-2.7
2009	-2.0	-25.3	3.9	-17.9	10.5	-0.3	1.3	128.0	116.0	6.9	5.7
2010	-2.8	-24.0	-0.9	-19.2	8.1	-1.5	3.8	129.0	119.0	7.6	1.7
2011	-2.9	-20.6	-2.1	-18.4	4.4	-2.0	2.6	129.0	121.0	8.2	3.8
Threshold	+6 %/ -4 %	-35%	+/-5 %euro area; +/-11 % non euro area	-6%	+/-9 % euro area; +/-12 % non euro area	6%	15%	160%	60%	10%	16.5%

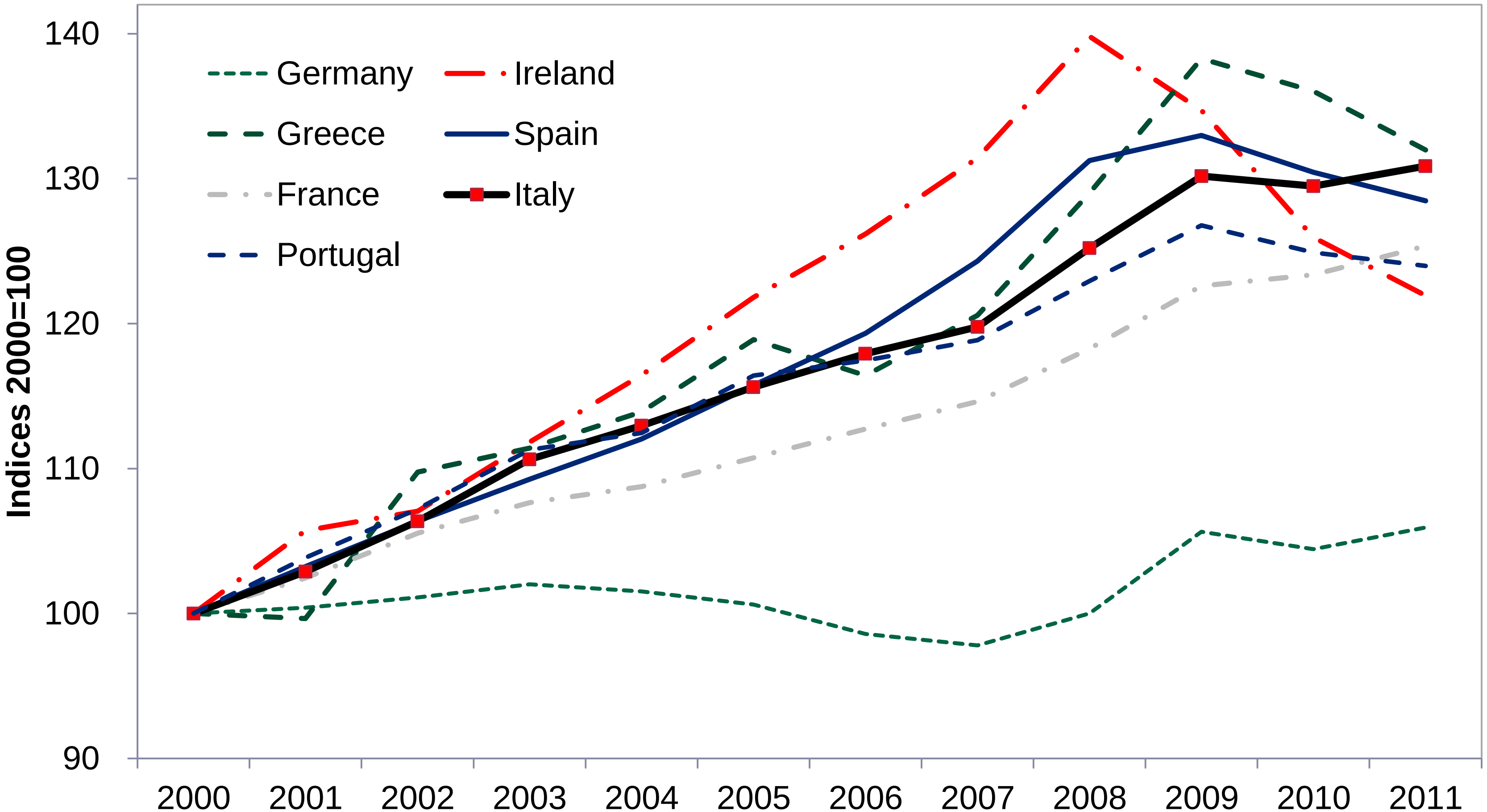
Source: MEF elaboration on Alert Mechanism Report 2013 (European Commission, November 2012)

Real house price: no need for further correction



Note: Data for Germany, France, Italy, UK and the Euro area are available for the first 3 quarters of 2012.
Source: OECD

Is competitiveness really deteriorating in line with ULC?



Source: Italian Ministry of Economy and Finance calculation on Eurostat data

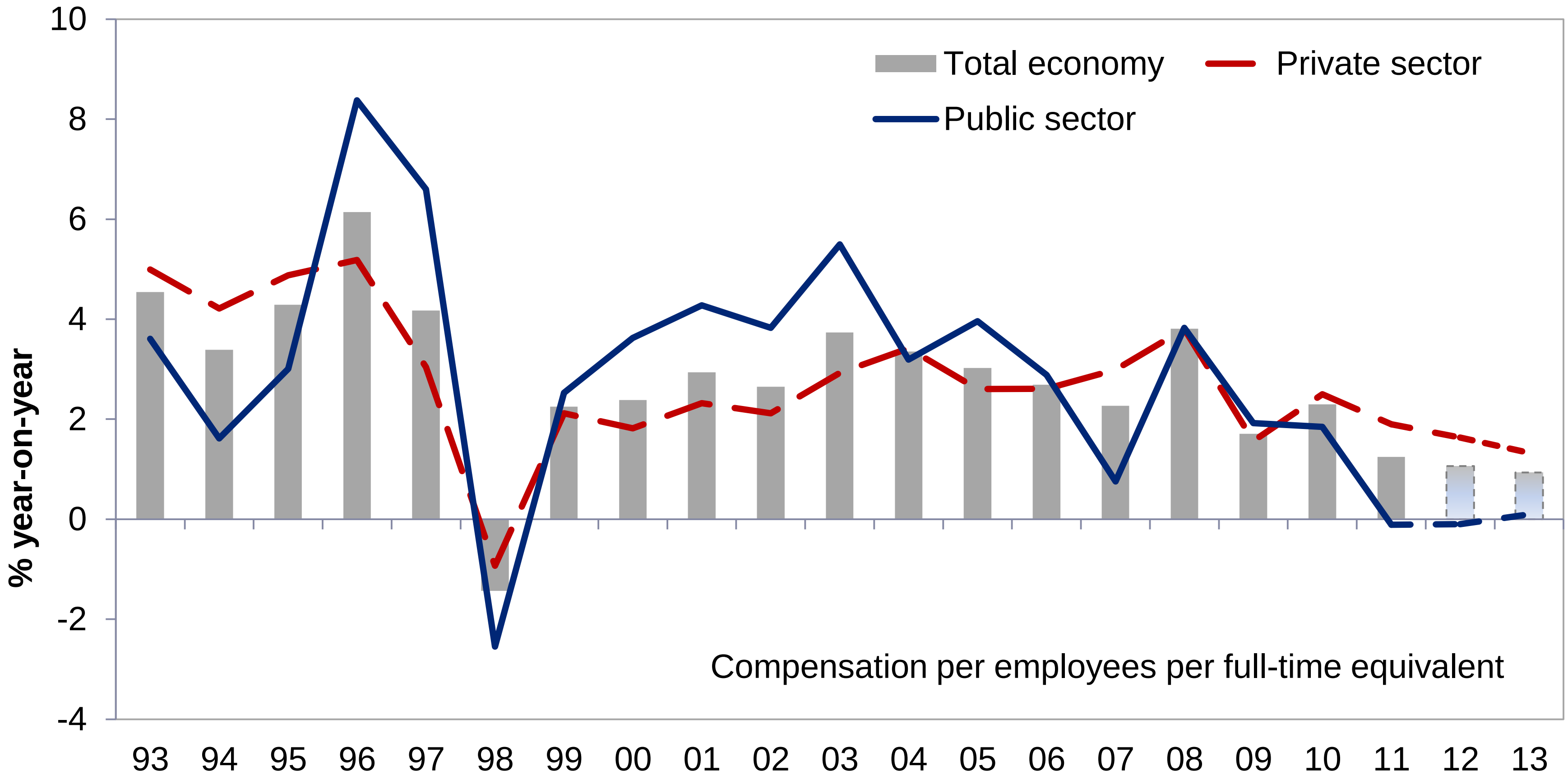
Dipartimento del TESORO

Ministero dell'Economia e delle Finanze

Unit labour costs: key Italian features versus EU partners

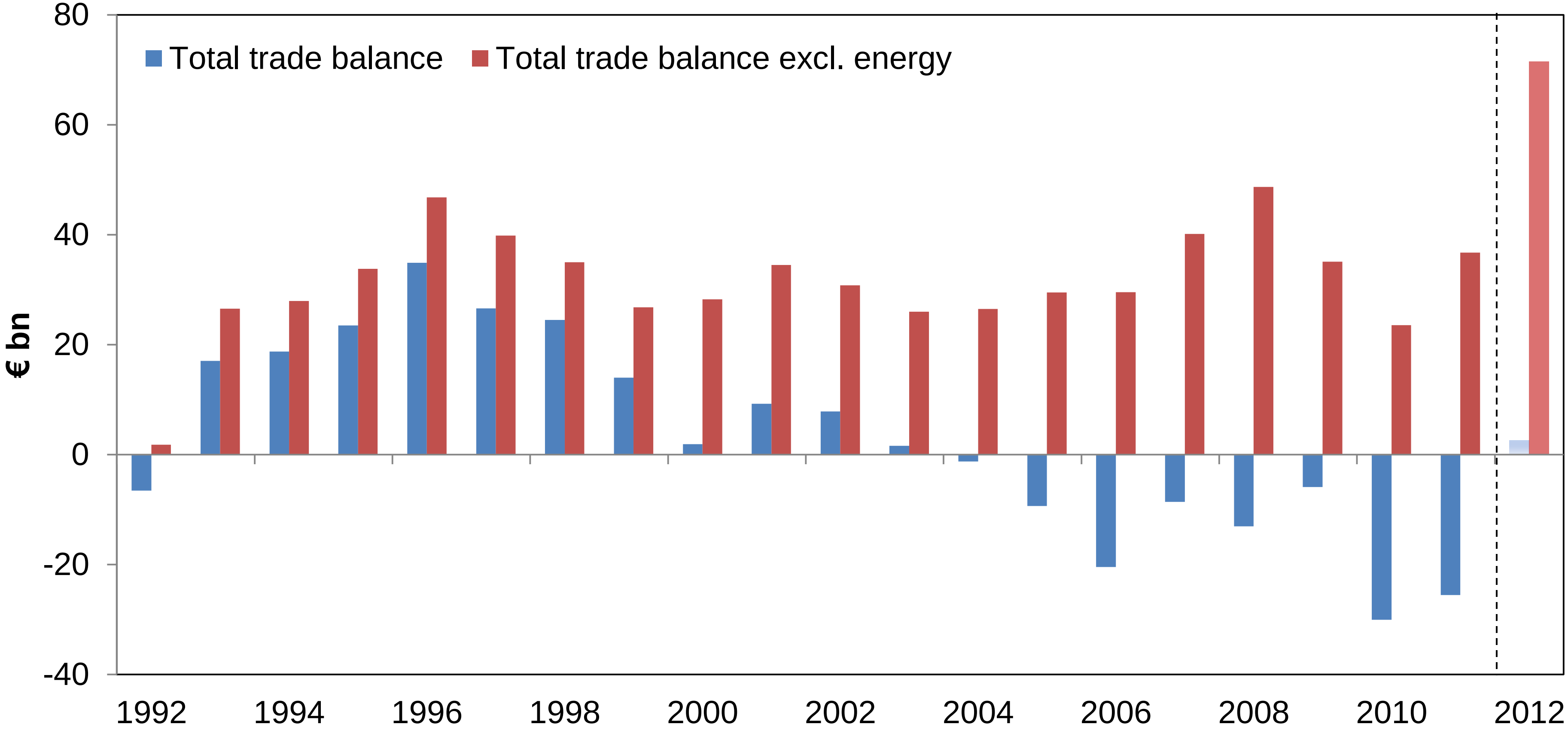
- Excessive growth in ULC: mainly due to **unfavourable developments in labour productivity**.
- **Limited downward adjustment in wages**: not enough to compensate for poor productivity growth and to address unemployment challenges.
- Wage dynamics: (a) **changing composition** of employment, (b) **severance payments** included in labour costs, (c) **time lag** in renewing collective agreements, (d) extended working life of higher-paid older workers due to pension reforms.

Private wage growth likely to ease further



Source: ISTAT
Note: MEF calculation on 2012 and 2013 data

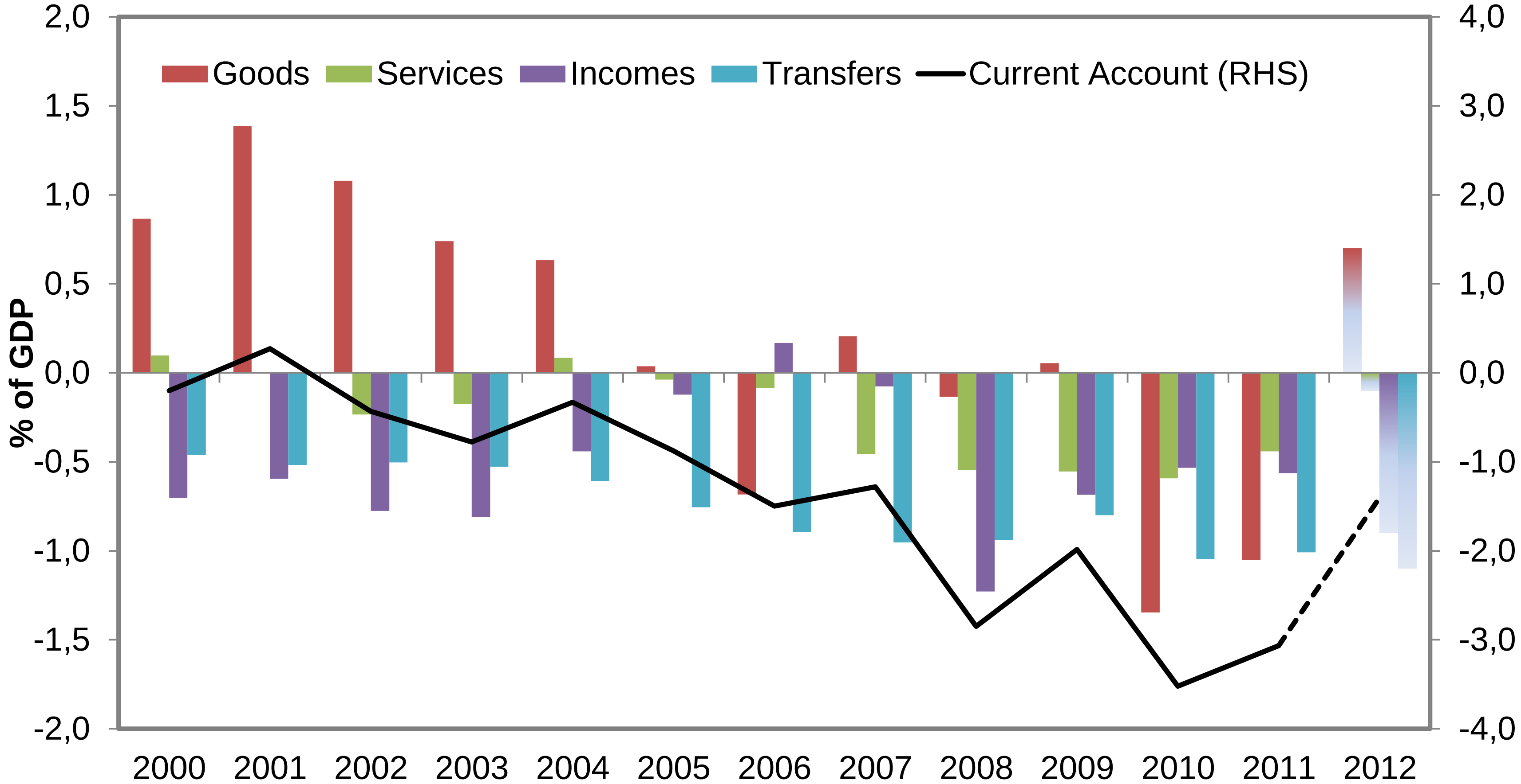
Sharp improvement in Italy's trade balance



Source: ISTAT. MEF calculation on 2012 total trade balance.

Note: Energy includes oil and natural gas. Total trade balance excl. energy refers to the period January-November 2012.

Current account deficit narrowing fast



Source: Bank of Italy Note: 2012 data are estimates as reported in the Update of 2012 Economic and Financial Document, September 20, 2012.

Dipartimento del TESORO

MEF Ministero dell'Economia e delle Finanze