

European Fiscal Board

**Assessment of the
fiscal stance appropriate for the euro area in 2024**

28 June 2023

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This report was written under the responsibility of the European Fiscal Board with the support of its secretariat.

Please quote as: European Fiscal Board (2023) Assessment of the fiscal stance appropriate for the euro area in 2024, Brussels.

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Cut-off date: 15 June 2023

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FOREWORD



Niels Thygesen

Chair of the European Fiscal Board (EFB)

Relief and pride are recurring and justified themes in reviewing the current economic and policy outlook. Less than four years from the outbreak of the Covid pandemic and less than two after the Russian invasion of Ukraine, 2024 looks like a return to normality in the euro area: labour markets have held up surprisingly well, most countries have avoided a recession in 2022 or 2023, supply constraints have eased, and output growth should keep the economy close to potential. Massive national and EU efforts to contain the crises, although not always adequately targeted, have overall been successful – with a remaining question mark on controlling inflation. To underline the sense of EU achievement, the recent terms-of-trade shock of over 2% of real income was twice as large as the one after the oil crisis of the early 1970s, when divergent national responses paralysed European integration for at least a decade.

After three years under the severe economic downturn clause, some normalisation is warranted also for the implementation of the EU's fiscal rules. The clause will be deactivated at the end of this year and the Commission has started again to issue quantitative fiscal guidance. If fully implemented by all countries, it implies a restrictive fiscal impulse for the euro area of 0.5% of GDP, without considering the recommended phase-out of energy support measures. Such an adjustment is to be assessed against the Commission forecast of 0.8% of GDP, in the absence of new budgetary measures. Hence, the Commission guidance would imply that Member States use part of the roll-back of energy measures for new fiscal initiatives.

The EFB considers that such developments would not amount to an appropriate fiscal stance for the euro area. *First*, within the overall monetary and fiscal effort, some additional rebalancing towards fiscal policy should be considered. This could ease the pace of raising interest rates and help contain risks of financial instability. *Second*, among the principles of the Commission's legislative reform proposal for the EU's fiscal rules are a medium-term perspective and country differentiation. These principles are valuable and realistic and seem to enjoy broad support. The envisaged medium-term perspective raises the question of whether there is still a case for a significant supportive fiscal stance at the current juncture. If next year is to be seen as normal, a structural primary budget deficit of close to 1% of GDP, as opposed to a long-term average of close to zero, seems on the high side. Barring new negative developments, an improvement in the structural primary balance beyond the 0.8% of GDP projected by the Commission would appear to be appropriate.

Excessive deficit procedures are another element of the fiscal framework set to signal a return to normality. Nine euro area countries are projected to face a headline budget deficit above the 3% of GDP reference value in 2023. The Commission has indicated readiness to open excessive deficit procedures in spring 2024 on the basis of budgetary out-turns of the previous year, which might already influence budgetary developments in 2024.

Next year is likely to mark a return towards normality. However, both short- and medium-term challenges may, in retrospect, make it look like an above-normal year. An appropriate euro area fiscal stance for 2024 should go beyond the phasing out of energy support measures, with the country distribution of extra efforts linked to now well-identified fiscal risks.

KEY MESSAGES

- Russia's war of aggression against Ukraine aggravated existing inflationary pressures and triggered a terms-of-trade shock that eroded real incomes in the euro area by more than 2% of GDP in 2022. This makes it an even larger shock than those experienced during the oil crises of the 1970s. Member States and the EU institutions reacted strongly to contain the economic fallout from the war in Ukraine.
- After the consecutive shocks of the Covid-19 pandemic and the energy crisis, it is projected in 2024 that there will be a return to a good macroeconomic performance with solid growth and a surprisingly tight labour market. The negative terms-of-trade shock of 2022 is partially offset by the recent falling energy prices, which should move the current account balance back towards a sizeable surplus.
- The Commission forecasts euro area core inflation to rise to nearly 6% in 2023 and remain above 3% in 2024. Second-round effects through wages and elevated profit margins pose an additional upside risk to inflation, which could trigger further monetary tightening beyond what is already expected.
- Despite the sharp rise in the ECB's main interest rates and the economic slowdown in 2023, unemployment did not rise, and the labour market remains tight. The euro area economy is projected to operate close to its potential in 2023 and 2024.
- Against this background, in March 2023, the European Commission cautioned against a broad-based fiscal stimulus in 2023 and 2024. Instead, it called on Member States to recalibrate energy crisis-related support measures to the most vulnerable. In the European Commission's surveillance package of spring 2023, fiscal guidance, without considering the recommended phase-out of energy support measures, implies a restrictive fiscal impulse of close to 0.5% of GDP in 2024.
- Based on unchanged policies, the European Commission actually projects a reduction in discretionary fiscal support for the euro area of 0.8% of GDP in 2024. Of note, the expected phase-out of energy support measures alone would amount to close to 1 ¼ % of GDP.
- Because of the favourable macroeconomic outlook, the EFB considers a restrictive fiscal impulse in the euro area appropriate in 2024. Moreover, falling inflation and rising interest rates will in due time provide less relief to public finances. Barring new negative developments, an improvement in the structural primary balance beyond the 0.8% of GDP projected by the Commission would appear to be appropriate.
- Fiscal consolidation remains particularly important for high-debt countries, which should make use of the beneficial excess of nominal output growth over implicit interest rates on government debt. In this light, the balance of Member States' contributions to the fiscal impulse in 2024 could be improved.
- A sizeable restrictive fiscal impulse would help the ECB in the pursuit of its inflation target. A fiscal policy stance that is too expansionary would imply higher interest rates with a potential knock-on effect on output and other macroeconomic variables.

1. Macroeconomic situation and outlook

The impact of the previous two crises is projected to largely fade away by 2024, signalling a return to more normal economic times. The Covid-19 pandemic no longer has a substantial affect on economic activity as all major economies have adjusted and infections are kept under control. The energy prices shock is expected to be essentially absorbed by 2024, barring an escalation of the war in Ukraine and of tense EU-Russia relations. However, the energy price shock may still cast shadows into 2024 as second-round effects on the labour market are projected to keep inflation high by historical standards. Overall, 2024 is expected to see a return to normality with regular rates of real economic growth. Discretionary fiscal support is likely to continue to shrink gradually as the need for energy support measures recedes and macro fundamentals are projected to remain strong. The impact of monetary policy tightening on financial markets and the real economy is likely to become more visible over 2023.

Real economic output is projected to expand rather more slowly than during the years leading up to the Covid-19 crisis. After a year of modest, yet higher than anticipated, real economic growth in the euro area in 2023, next year is expected to see a small rebound to just over 1.5%, which would be somewhat lower than in pre-pandemic times ⁽¹⁾ (see Graph 1.1). Current projections for 2024 are based on the assumption that there will be no major disruptions or even shortages in energy supply in the winter of 2023/2024. This will depend on the severity of the winter, the amount of energy that stored achieved before the heating season starts, the sustained reduction of energy consumption, the global demand for energy, and the success of the EU's energy diversification activities over 2023.

⁽¹⁾ The average real GDP growth in the euro area between 2015-2019 was close to 2%.

Differences in the rates of economic growth across euro area Member States should narrow in 2024. The terms-of-trade shock affected all euro area countries but the severity of the impact on real incomes differed greatly depending on the energy mix, the trade intensity with Russia or Ukraine, the energy intensity of industry and the ability of domestic exporters to impose higher energy costs on foreign customers (see Section 3). However, the European Commission's 2023 spring forecast suggests that the difference in growth rates across countries will narrow in 2024 to a historically low gap between the weakest and fastest growing economy (see Graph 1.3). In particular, all euro area countries are at last projected to have moved beyond their pre-pandemic levels of annual real economic output by 2023, with Spain being the only country projected to have not achieved this already by 2022 or earlier (see Graph 1.2).

Real economic activity should expand in 2024 thanks to recovering consumer spending and investment. The global economy is set to grow at a slightly slower pace than during the past decade, but still at over 3%. Moreover, supply-chain impediments are expected to lessen, particularly due to the reopening of China after it lifted its zero-Covid policy. These favourable conditions are projected to bring trade volume growth back to pre-pandemic rates (see Graph 1.4). Nevertheless, euro area net exports are not projected to significantly contribute to economic growth in 2024. The main drivers of demand will be private consumption and investment. However, economic sentiment indicators continue to show a somewhat negative perception of prospects despite a small improvement over recent months (see Graph 1.7). Nevertheless, total gross fixed capital formation as a share of GDP is expected to reach levels last observed before to the global financial crisis of 2008 and significantly higher than over the past decade.

Labour markets are expected to remain strong throughout the energy crisis and into 2024. Despite a slowdown in economic growth expected in 2023, the unemployment rate is predicted to remain virtually unchanged. The Commission's 2023 spring forecast even projects the unemployment rate to drop slightly in 2024, moving to yet another historical low of less than 7%. In 2024, all euro area Member States can expect their unemployment rates to fall further to below the levels seen before the war in Ukraine. While the range of unemployment rates across countries will also narrow, the differences remain substantial (see Graph 1.12). The employment and participation rates of the euro area are projected to continue rising until 2024 (see Graph 1.13).

The dynamics in vacancies and labour shortages point towards a persistently tight labour market. As the use of job-retention schemes fades, total hours are starting to catch up to employment dynamics (see Graph 1.10), indicating less unused labour supply in existing contracts. Similarly, vacancies remain at a record high (see Graph 1.14), especially compared to the number of jobseekers. Employers signal lack of skilled labour as the main impediment to expanding production. These labour shortages are becoming even more pressing in sectors key to the digital and energy transition, given the ambition to increase investment in these areas.

Inflation is expected to remain above the ECB target by 2024 and risks are tilted to the upside. The war in Ukraine amplified existing inflationary pressures and prices soared in 2022 by over 8% in the euro area (see Graph 1.6). The ECB reacted strongly to the price shock and gradually raised its deposit facility rate from -0.5% before the war to 3.5% in June 2023. In its monetary policy decisions in May and June, the ECB slowed its rate hikes from previous 50 basis point increases to 25 basis point increases (2). At the same time the ECB announced that it would discontinue reinvestments under its asset

purchase programme (APP) as of July 2023. The ECB announced it will continue to follow a data-dependent approach (3). Financial markets are pricing in additional future interest hikes. The European Commission's 2023 spring forecasts projects that euro area inflation will remain high also in 2023 with a headline and core rate (HICP) of close to 6%. International institutions project the headline inflation rate to fall to around 3% in 2024 (4) (see Graph 1.6). As the energy price hike of 2022 falls out of the inflation index, price pressures will stem increasingly from other products and services as well as from second-round effects through wage settlements (5) and elevated unit profits (6). Moreover, the risk remains that, in the lead-up to and during the winter season of 2023, energy prices may rebound as temperatures fall, despite diversification of supplies and remarkable energy savings (7).

The euro area economy is expected to operate close to its potential in 2024. The labour market has been remarkably resilient over recent years. Despite the energy crisis, labour market performance has not deteriorated, and it is estimated that aggregate output marginally exceeded potential in 2022 and 2023. The Commission expects the economy to continue to operate broadly at its potential in 2024 (see Graph 1.8). However, the impact of the Covid-19 crisis on production capacity may only become gradually apparent due to government support measures and moratoriums on insolvency procedures during the pandemic. Non-performing loans have continued their downward trajectory, but the number of so-

(2) [See key ECB interest rates.](#)

(3) [ECB press conference](#) on 4 May 2023.

(4) ECB Macroeconomic projections of December 2022 still indicated an inflation rate of 2.9% in 2024.

(5) See [ECB wage settlement indicator](#).

(6) See, for example, [ECB decomposition of the GDP deflator](#).

(7) For example, natural gas demand fell by 13% in 2022 compared to 2021. For more details, see [IEA \(2023\)](#).

called stage-2 loans have been increasing ⁽⁸⁾. The energy crisis is also likely to have affected the viability of some businesses, as energy prices are expected to remain significantly above pre-2021 levels. These scarring effects may have reduced potential output and forecasters may turn out to have been too slow in recognising the emergence of a positive output gap in 2022 preserved through 2023.

The European Commission sees risks to the baseline forecasts tilted towards the downside. The threat of renewed restrictions on economic activity due to the Covid-19 pandemic has largely disappeared. The war in Ukraine and an intensified conflict with Russia obviously pose a downside risk. Energy rationing or shutdowns in the winter season of 2023 remain possible but thanks to high levels of energy storage in Winter 2022, energy savings and diversification, such a scenario has become less likely. However, if it were to happen, it would pose a severe threat to the economic outlook. Core inflation has surprised on the upside, and it is possible that inflation will remain sticky, which would increase the likelihood of further monetary tightening. This would weaken growth prospects, pose a potential challenge for financial stability and produce negative feedback on sovereign bond markets. At the same time, domestic demand could turn out to be higher than expected in case consumer and producer sentiment improves and the terms-of-trade shock reverses. The reopening of China after the zero-Covid policy could create a stronger boost to global demand than currently anticipated, and support euro area industrial exports, as well as the service sector, particularly international tourism.

⁽⁸⁾ These are loans that are still performing but whose risks have significantly increased since they were made.

2. Fiscal policy developments

The nature of economic shocks over recent years calls for precise language when discussing fiscal policy. The EFB's assessment of the fiscal stance evaluates the need for fiscal stabilisation subject to sustainability constraints. As in previous years, a distinction is made between the fiscal stance and the fiscal impulse ⁽⁹⁾. In line with the relevant and well-established literature ⁽¹⁰⁾, the EFB defines the discretionary fiscal stance as the structural primary balance in a given year, which approximates the general level of fiscal support provided by governments apart from automatic stabilisers. The annual change in the fiscal stance is referred to as the fiscal impulse. The fiscal impulse can also be derived from the expenditure benchmark (see Glossary). The distinction between the fiscal stance and the fiscal impulse is particularly important for clear messaging at times of large economic swings and sharp shifts in fiscal support. For instance, a slightly contractionary fiscal impulse may well coincide with a supportive fiscal stance if there had been a substantial level of fiscal support in the previous year. ⁽¹¹⁾ The fiscal impulse and fiscal stance are only approximations of the impact discretionary fiscal policy has on aggregate demand due to several uncertainties affecting their measurement (see Glossary). In the following, the fiscal stance and fiscal impulse are analysed in the context of the extent and dynamics of the cyclical conditions.

Barring new policy measures, public finances are projected to improve in 2024.

The euro area headline budget deficit is expected to shrink by nearly 1% of GDP in 2024, which would bring it below 3% of GDP for the first time since the start of the pandemic (see Graph 2.3). The projected fall in the deficit is: (i)

⁽⁹⁾ See EFB report on the [assessment of the euro area fiscal stance in 2022](#).

⁽¹⁰⁾ See [Heller et al. \(1986\)](#).

supported by a still sizeable increase in the GDP deflator of close to 3% next year (see Graph 1.11); and (ii) reflects the usual no-policy-change assumption, i.e. it does not include the effects of the budget plans for 2024, to be finalised in the autumn. Government borrowing costs began to gradually rise in 2022 for the first time since the global financial crisis of 2008. However, so far, their budgetary impact remains modest in the euro area as a whole (an increase of ¼% of GDP since 2020) as debt maturities have been lengthened over the past decade and only a small part of the debt is inflation-linked ⁽¹²⁾. The budgetary impact of the automatic stabilisers is forecast to be near zero as cyclical conditions are estimated to remain stable and the labour market to maintain its strength.

Fiscal measures taken to address the impact of soaring energy prices continue to drive the dynamics in budget balances. Energy support measures are not classified as “one-offs” and thereby affect the fiscal stance. Tracking the budgetary impact of the measures is not always straight-forward. Currently, energy measures are projected to increase further in 2023 as some initiatives are rolled over and new ones are being adopted. However, the net costs of energy measures may turn out to be lower than previously expected. The reason is that energy prices have subsided over the winter compared to the peak of summer 2022, which limits the fiscal costs of price cap systems. The baseline assumption of the European Commission is that, by the end of 2023, energy support measures will have largely expired. However, a harsh winter and rebounding energy prices would delay their phase-out well into 2024. Moreover, policy inertia driven by political considerations may result in some measures being left in place over the medium term. For some countries, military expenditure also rose

because of the war in Ukraine and may continue to weigh on the budget balance ⁽¹³⁾.

Discretionary fiscal support is projected to decline in 2024 but remains significant. The highly supportive fiscal stance that emerged at the onset of the Covid-19 pandemic gradually shrank over 2021-22 (see Graph 2.5). This trend is expected to continue in 2023 and 2024 as fiscal support is gradually withdrawn. In other words, the situation is one of a contractionary fiscal impulse, but a still supportive fiscal stance. Concretely, current estimates suggest a contractionary fiscal impulse of 0.8% of GDP in 2024, bringing the structural primary deficit to below 1% of GDP, although it remains substantial and well above the euro area long-term average ⁽¹⁴⁾. Including interest payments, the structural deficit is projected to decline to around 2½% of GDP. The fiscal impulse derived from the expenditure benchmark also indicates a withdrawal of discretionary fiscal support, which amounts to ¾% of GDP for 2024.

The impact of the Recovery and Resilience Facility (RRF) grants on aggregate demand in 2024 remains broadly unchanged. RRF grant-financed expenditure in 2023 as well as 2024 amounts to nearly 0.5% of GDP for the euro area as a whole. The RRF will therefore still support the level of aggregate demand but not more than before, thus not adding to the nationally-financed fiscal impulse (i.e. the change in the level of discretionary fiscal support). Additional RRF financing was made available through REPowerEU ⁽¹⁵⁾ in response to the soaring energy prices, but as these are mostly loans and not grants, they will be automatically captured in the conventional fiscal impulse indicator ⁽¹⁶⁾.

⁽¹¹⁾ For a more detailed discussion, see the EFB’s report (Box 1) on the [assessment of the euro area fiscal stance](#).

⁽¹²⁾ See [Graeve and Mazzolini \(2023\)](#).

⁽¹³⁾ See e.g. [SIPRI Military Expenditure Database](#).

⁽¹⁴⁾ The average structural primary balance of the euro area between 2000-2022 has been close to 0% of GDP.

⁽¹⁵⁾ See [REPowerEU under the RRF](#).

⁽¹⁶⁾ See EFB’s report (Box 2) on the [assessment of the euro area fiscal stance](#).

The Commission’s fiscal guidance for 2024 returns to detailed quantitative fiscal requirements.

An extensive interpretation of the severe economic downturn clause has been applied since the onset of the Covid-19 pandemic. It has effectively suspended all normal implementation of the EU fiscal rules. Notably, since 2020 the Commission has started to employ elements of demand management also in its surveillance framework for fiscal compliance ⁽¹⁷⁾. The country-specific fiscal guidance issued in 2021 for 2022 was expressed in terms of the fiscal impulse ⁽¹⁸⁾ and for countries with debt ratios above 90% guidance contained further recommendations on elements of the fiscal impulse, namely current expenditure and public investment. The surveillance cycle of 2024 will be the first one in which the severe economic downturn clause is no longer applied. In its Communication published on 8 March 2023, the Commission stressed that a broad-based fiscal stimulus is not warranted for 2023 or 2024 and that any remaining energy support measures should become more targeted. On 24 May 2023, the Commission issued quantitative fiscal guidance to governments.

The Commission’s fiscal guidance amounts to a restrictive fiscal impulse for the euro area in 2024. Fiscal guidance issued on 24 May 2023 called for a benchmark structural adjustment of 0.5% of GDP for those Member States that have not achieved their respective MTO (see Glossary). The benchmark adjustment is further calibrated by +/- 0.2% of GDP depending on fiscal sustainability considerations. The fiscal adjustment noted in the recitals was expressed both as the change in the structural balance and the corresponding growth in net nationally financed primary

expenditure. However, in the recommendations only the latter was used. Aggregating the required structural adjustment across euro area countries, implies a fiscal impulse of 0.5% of GDP for 2024, without considering the recommended phase-out of energy support measures. Notably the Commission also called upon Member States to phase out remaining energy measures amounting to close to 1 ¼ % of GDP by the end of 2023. At unchanged policies, the Commission’s 2024 spring forecast projects a restrictive fiscal impulse for the euro area of 0.8% of GDP.

The EFB views a restrictive fiscal impulse in 2024 as warranted.

Energy prices have started to moderate considerably relative to the peak observed during 2022. As energy costs revert towards pre-war levels and barring any surprises, fiscal measures taken in response to soaring energy prices should be gradually phased out. Moreover, even if another terms-of-trade shock should occur, it would not warrant a broad-based fiscal expansion of the type launched in 2022. Some targeted support may still be justified in 2024, but such expenditure should be financed either by additional revenues or through reallocating existing budgetary resources. International institutions project the euro area economy to operate close to its potential in 2024 and labour markets to remain surprisingly tight. In particular, potential output generally tends to be overestimated in real time ⁽¹⁹⁾. Therefore, 2024 could very well *ex post* fall into the category of economic good times. Moreover, the expected fall in inflation coupled with increasing interest rates will provide less relief on public finances in the medium term. This calls for an even more cautionary approach and more restrictive impulse than currently projected (see Graph 2.5 and 2.6).

⁽¹⁷⁾ For a more detailed discussion see EFB’s forthcoming Annual Report of autumn 2023.

⁽¹⁸⁾ In this case, measured as the change in primary expenditure relative to the medium-term potential growth benchmark, which is net of discretionary revenue measures and excluding so-called crisis-related temporary emergency measures while including measures financed by RRF grants and other EU funds.

⁽¹⁹⁾ See for example [Larch et al. \(2021\)](#) or [IMF \(2020\)](#).

High-debt countries should contribute more to the restrictive fiscal impulse in order to reduce risks to the sustainability of public finances. The European Commission's Debt Sustainability Monitor (DSM), published on 14 April 2023 ⁽²⁰⁾, underscored the significant risks to the sustainability of the public finances in some euro area countries. The Commission classified eight countries as facing high risks in the medium term and six in the long term. The former group consists of Member States with high-debt ratios, while the latter is strongly influenced by the expected rise in costs related to ageing. In its fiscal guidance issued on 24 May 2023, the Commission recommended a structural adjustment faster than the 0.5% benchmark for countries with more considerable debt sustainability challenges and a slower pace for those with low sustainability risks were required to adjust at a lower pace. The required structural adjustment ranged from 0.3% to 0.7% of GDP. Currently, all euro area Member States, except Croatia, are projected to enact a restrictive fiscal impulse (based on the structural primary balance) in 2024 (see Graph 2.16). Similarly, the fiscal impulse derived from the expenditure benchmark indicates a restrictive fiscal impulse in all euro area countries for 2024 on the back of the phasing out of measures related to the energy crisis. However, the overall reduction in the level of discretionary fiscal support stems equally from low/medium-debt countries and from high-debt countries – while a relatively larger contribution from the latter would be warranted (see Graph 2.8). Both the sustainability and stabilisation analyses of most countries suggest that a restrictive fiscal impulse would be appropriate (see Graph 2.17). The analyses further show a mixed picture among high-debt countries in how far the restrictive impulse matches the required adjustment derived from a sustainability perspective ⁽²¹⁾.

⁽²⁰⁾ [Debt Sustainability Monitor 2022](#).

⁽²¹⁾ Assuming a continued linear structural adjustment achieved over 5 years and thereafter maintaining that budget balance until 2070, at

A restrictive fiscal impulse would help the ECB reduce inflation towards its target.

Fiscal measures taken in response to soaring energy prices have slowed the reduction in discretionary fiscal support in 2022 and 2023. This poses a challenge for monetary policy. The ECB has warned that broad-based fiscal support 'could ultimately force monetary policy to raise interest rates beyond the level that would be seen as appropriate without fiscal stimulus' ⁽²²⁾ and repeated these warnings as energy prices fell ⁽²³⁾. Some energy measures such as gas and electricity price caps or VAT cuts on energy products have temporarily reduced headline inflation but once phased out, they will have the opposite effect. The ECB estimates that compensation measures against soaring energy prices reduced inflation by close to 1 percentage point (pp) in 2022 and another 0.5 pps in 2023. However, the withdrawal is projected to raise headline inflation by 0.7 pps in 2024 ⁽²⁴⁾. Moreover, broad-based income measures partially shielded real incomes and stimulated consumption, thereby adding immediate inflationary pressures but also future wage pressures. Core inflation is expected to remain elevated in 2024 at above 3%, while labour markets remain exceptionally tight. A restrictive fiscal impulse would be appropriate not only from a fiscal policy perspective but also from a monetary policy perspective in moving towards its inflation objective; both help in stabilising the economy over the business cycle.

3. Impact of the terms-of-trade shock

The war in Ukraine aggravated existing inflationary pressures. Supply-chain disruptions that emerged during the Covid-19 pandemic and release of pent-up demand during the recovery phase exerted inflationary price pressure across various goods and services.

which point debt is set to fall below 60% of GDP.

⁽²²⁾ [Keynote speech by Isabel Schnabel](#) (24 November 2022).

⁽²³⁾ [Press conference of Christine Lagarde](#) (16 March 2023).

⁽²⁴⁾ ECB economic bulletin 2023, issue 1 and 2.

During the second half of 2021, inflation started to pick up after a long period of subdued price increases. The war in Ukraine that started in February 2022 added a supply-side push to inflation, as energy prices soared to record levels.

A terms-of-trade shock can be thought of as a wealth transfer among countries. The EU and its Member States are net importers of energy and energy-related products, in particular oil and gas. The sudden spike in energy prices constituted a severe, adverse terms-of-trade shock to the EU. The terms-of-trade refer to export prices relative to import prices that a specific country faces. A sizeable rise in import or export prices creates a negative or positive terms-of-trade shock. A prime example of a negative shock are the soaring energy prices. Part of the increased energy costs will be re-exported by the domestic producers and simply passed on to foreign importers of other goods. Nonetheless, a large part of the adverse terms-of-trade shock has to be borne by the domestic economy where real incomes decrease, rendering it poorer in the aggregate. It can be thought of as a wealth transfer from energy importers to exporters. A terms-of-trade shock also affects the real income distribution within a country.

The implications of the terms-of-trade shock to real income are well understood, but what has been the scale of the shock and how important might the counter-shock of falling energy prices in 2023 and 2024 prove to be?

Scale of the terms-of-trade shock in the euro area

Energy prices in the euro area have increased more sharply than at any time since the euro was introduced. Historically, large swings in the terms-of-trade are highly correlated with sharp movements in energy prices. At least for the EU and euro area, import prices of energy and related products have been the main driver over the past decades ⁽²⁵⁾. This

⁽²⁵⁾ See ECB Economic Bulletin 2022/3.

justifies a closer look at the price changes for energy over these decades to get a perspective of the recent hike of historical proportions (see Graph 3.1). Given the share of energy in final consumption, and its role as an intermediate input, an energy price hike is also a key determinant of overall inflation.

The terms-of-trade worsened in 2022 at a speed and with a ferocity not seen over the previous 20 years. At the (preliminary) peak, import prices rose by over 30% compared to the same month of the previous year (see Graph 3.2). However, export prices also rose substantially but clearly less than those of imports. This pass-through of increased (import) prices by exporters to foreign clients limits the overall impact on the terms-of-trade. The reduction in energy consumption of households and businesses (particularly in energy-intensive sectors) lessened the impact of soaring prices on the terms-of-trade. Nevertheless, the gap between import and export inflation indicates a worsening in the terms-of-trade far above any previous episode. As a result, the 2021 current account surplus of the euro area of 3.5% of GDP nearly disappeared in 2022. The scale of the terms-of-trade shock can be further illustrated by the difference between changes in the consumer price index and the GDP deflator. Unlike the harmonised consumer price index, the GDP deflator is not based on a household consumption basket. Instead, it measures the change in prices of all domestically produced goods and services minus the change in import prices (see Graph 3.3).

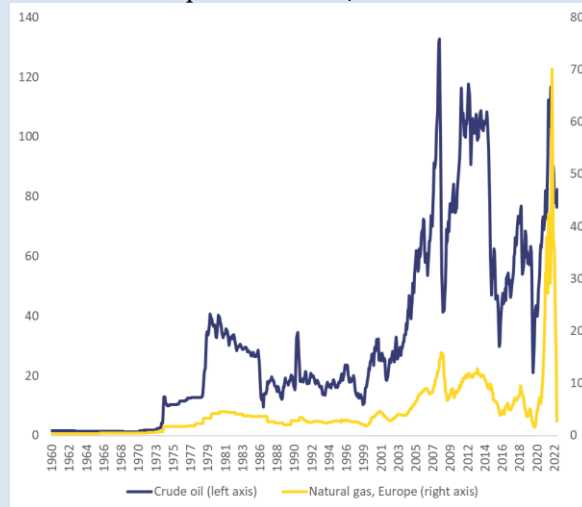
The drastic worsening in the terms-of-trade had major implications for real incomes in the EU and euro area. For both, real incomes declined by close to 2.5% of GDP in 2022, following a decline of 1% of GDP in 2021 when energy prices started to climb (see Graph 3.4). In historical terms, this impact of the terms-of-trade shock on real incomes is far larger than that of any previous terms-of-trade shock – even when compared with the losses during the two oil crises of the 1970s (see Box 1).

Box 1: Comparison with the 1970s oil price shocks

The soaring energy prices in the wake of the war in Ukraine are in many ways reminiscent of the oil crises in the 1970s, but there are also significant differences. Starting with the parallels, both oil crises in the 1970s were triggered by a war – namely the Yom Kippur war of 1973 and the Iraq-Iran war following the Iranian revolution of 1979. Energy exports fell in general; in some cases, sharpened by embargoes imposed against some importers, creating acute shortages. Moreover, monetary policy had been very accommodative leading up to the recent energy crisis and those of the 1970s making it easy to implement sharp price hikes.

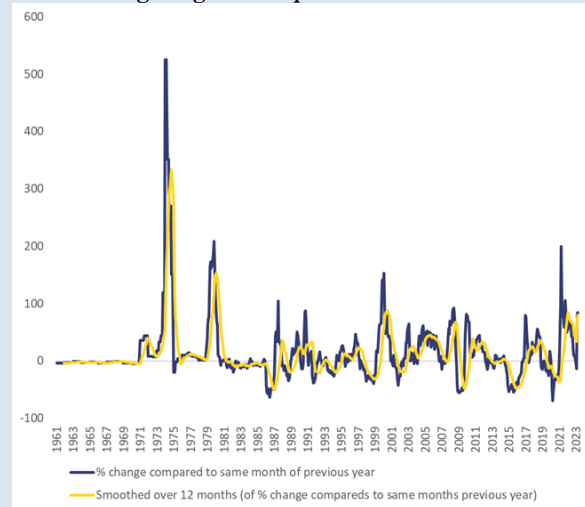
Crude oil prices had been very stable during the 1960s but shot up in 1974 (see graph on the left-hand side below). In both nominal and real terms, the oil price after the shock may appear modest by modern standards, but it constituted a five-fold increase within just a few months (see Graph on the right-hand side below). The late 1970s saw another doubling of crude oil prices, before dropping sharply in the mid-1980s. The recent period of soaring energy prices was reflected in a doubling of the oil price, but the effect was more sizeable on the gas market, where prices rose six-fold at its peak.

Global oil and as prices over time, USD



Source: EFB based on World Bank data.
Note: Latest observation is April 2023.

Percent change in global oil prices over time



Source: EFB based on World Bank data.
Note: Latest observation is April 2023.

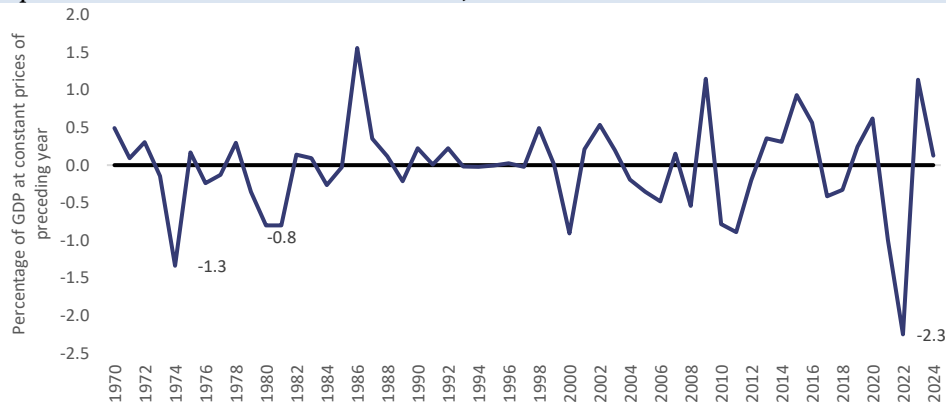
The terms-of-trade deteriorated significantly during the first oil crisis and more moderately during the second, albeit for 2 years in a row (see Graph below). Real income experienced a historically sharp drop of 1.3% of GDP in 1974, but this was still far smaller than the fall by 2.3% of GDP in 2022.

In particular, a terms-of-trade shock may worsen real incomes, but it could also increase them, when energy prices reverse direction leading to a positive terms-of-trade shock. For example, a very sizeable positive terms-of-trade shock occurred in 1986, a few years after the second oil crisis as global crude oil prices plummeted. Similarly, the European Commission now projects a positive terms-of-trade shock of close to 1% of GDP to occur in 2023).

Given the sharp increase in oil prices and the dramatic events of the 1970s, it may seem odd that the terms-of-trade shocks were markedly smaller than in 2022. This is where the differences in the structure of the economy and the policy responses come into play. A key factor is that in the 1970s import dependence for oil/energy was lower given the still existing local production. This meant at that the time some of the oil price jump also benefited domestic producers. Domestic production has since then declined in relative terms and led to greater dependence on foreign oil as well as gas. Overall, globalisation was not at the same level as today. During the early 1970s cross-border trade in goods and services ⁽²⁶⁾ as a share of GDP by euro area countries was just over 30% whereas it exceeded 90% in 2021. Therefore, at the time, the terms-of-trade shock had a smaller impact on real income given the smaller share of imports (both energy and overall) in GDP.

⁽²⁶⁾ For comparability with the 1970s, figures include intra-euro area trade.

Impact of terms-of-trade shock on real income, euro area



Source: EFB based on European Commission data.

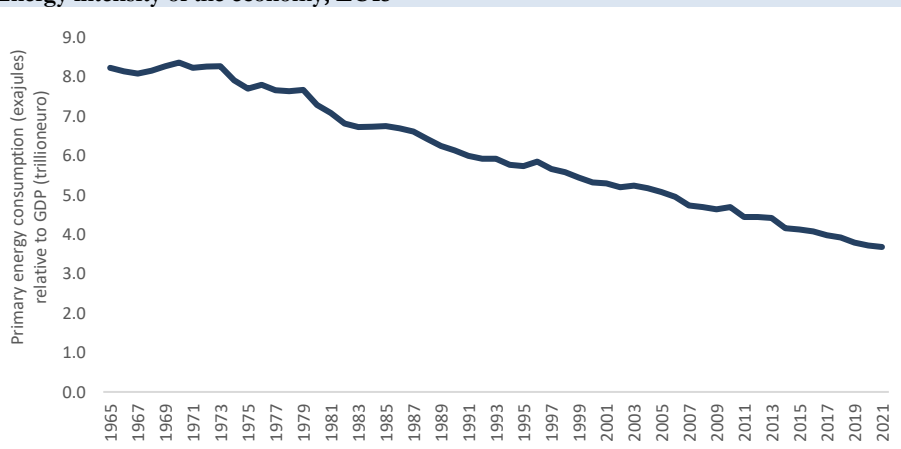
Note: Derived as nominal export of goods and services divided by the import deflator minus real exports. The change of this term compared to the previous period is divided by real GDP to estimate the impact of the terms-of-trade on real income.

Another factor that affected the impact of the shock on the economy and society is the decline in energy intensity over recent decades. Industrial production had a larger share of the economy and energy efficiency was far below today's standards. This is reflected in the ratio of primary energy consumption relative to economic output (see graph below), which was halved between the 1970s and 2021. This meant that all things being equal higher energy prices had a more severe impact on household budgets and industrial profitability. Without this downward trend in energy intensity, the shock of 2022 would have been even starker compared to that of the 1970s.

The energy price shock of the 1970s created lasting effects on inflation. Due to strong unionisation and proliferating automatic wage indexation, price shocks had profound second-round effects and became easily entrenched in a wage-price spiral. Moreover, in the 1970s, policy responses varied significantly across Europe and North America. Hardly any central bank had price stability as a primary objective. Most central banks and governments pursued employment and growth objectives. In the absence of any joint management of intra-European exchange rates, there were no constraints on the evolution and divergence of national inflation rates.

Following the oil crises, the monetary policy paradigm shifted towards a primary focus on price stability and as a result stronger reactions to inflationary overshoots – the US Federal Reserve's interest rate hike in 1979-1980 under its then chairman Paul Volcker being the prominent example. This paradigm is observed today to some degree by the ECB, which started a steep interest climb following soaring inflation rates. But, so far, the trade-off with employment has not materialised although this may still change.

Energy intensity of the economy, EU15



Source: EFB based on data from the European Commission and BP database.

The terms-of-trade shock affected both aggregate demand and supply. The increase in import prices constrained production as inputs became more expensive and profitability was reduced as not all costs could be passed on. At the same time, imported price hikes severely cut into real wages since salary increases compensated only a part of the inflation (see Graph 3.5).

Expansionary fiscal policy cannot remove the impact of the terms-of-trade shock on national real income; it can only redistribute the burden. A terms-of-trade shock creates an inflation hike, thereby reducing domestic disposable income. It may impede aggregate supply. The shock must be absorbed while redistributive measures can alleviate pressures on vulnerable households and firms. Means-tested fiscal support protects households with lower incomes but may create a cliff effect for lower middle-class households if the policy is not implemented in a gradual manner ⁽²⁷⁾. This message was clearly reflected in official communications issued throughout 2022 by the Commission ⁽²⁸⁾ and Eurogroup ⁽²⁹⁾. The latter stated on 11 July 2022 ‘that supporting overall demand through fiscal policies in 2023 is not warranted, the focus being instead on protecting the most vulnerable’. Trying to compensate everyone for the shock would shift the burden onto future taxpayers, casting doubt on intergenerational fairness.

The fiscal response to the terms-of-trade shock was generous. The level of fiscal support shrank in 2022 due to the withdrawal of Covid-related measures adopted in the previous 2 years. However, the budgetary improvement was much smaller than projected in the budgetary plans drawn up in 2021. This shortfall was mostly driven by the new energy measures adopted in 2022, which are estimated at a net

cost ⁽³⁰⁾ of 1 ¼ % of GDP in 2022 alone ⁽³¹⁾. The fiscal response was therefore not focused on redistribution within the planned budget but rather relied on additional borrowing. Energy measures compensated for nearly half of the loss of real income accrued by the terms-of-trade shock in 2022 – with the former amounting to 1¼ % and the latter estimated at 2.3% of GDP.

The initial fiscal policy response to the terms-of-trade shock was not sufficiently targeted. In contrast to the consensus against a broad-based fiscal impulse voiced by the Eurogroup, the Commission assessed that energy measures had been largely untargeted in 2022, consisting partly of general reductions in taxes and duties and non-means-tested transfers. According to the Commission’s 2023 spring forecast only around a quarter of the measures could be considered targeted to the most vulnerable. The Commission expects nearly all energy measures to be phased out by 2024. However, reversing support measures may prove politically challenging, but first preliminary indications point to a shift in the right direction.

Cyclical conditions and high inflation would have warranted a sizeable reduction in discretionary fiscal support. Economic output exceeding its potential and labour markets becoming increasingly tight pointed to a cyclical upswing in 2022, despite the negative impact of the war in Ukraine. Against this backdrop a sizeable counter-cyclical restrictive fiscal impulse should have been pursued. The substantial energy measures may prove counterproductive as they are likely to further stoke inflationary pressures over the medium term by worsening the mismatch of demand and supply. Fiscal interventions in prices may provide a temporary inflation buffer but their eventual reversal will have the opposite effect. A sizeable restrictive fiscal impulse in 2022 and 2023 flanked by

⁽²⁷⁾ See [IMF \(2022\)](#).

⁽²⁸⁾ See 2022 European Semester: Spring Package Communication and 2023 Recommendation on the economic policy of the euro area.

⁽²⁹⁾ See Eurogroup statements of 11 July 2023 and 3 October 2023.

⁽³⁰⁾ Total budgetary costs of energy measures are netted of revenues from windfall profits of energy companies.

⁽³¹⁾ [European Commission 2023 spring forecast](#).

redistributive measures would have helped monetary policy dampen inflationary pressures in 2022 and beyond.

Diverse impact of common shock

The terms-of-trade shock affected all EU Member States, but vulnerabilities differed greatly. Differences can be explained by the varying degrees of exposure to Russia and Ukraine as well as the energy mix, the share of energy in a household's consumption and the energy intensity of industry ⁽³²⁾. Before the war nearly one quarter of gross available energy in the EU was imported from Russia but the share could be over 50% in some Member States ⁽³³⁾, abstracting from differences in ability to switch energy supply (see Graph 3.6). Eastern European countries tended to have the biggest general trade dependencies with Russia and Ukraine ⁽³⁴⁾. Several countries with a high share of gas in energy production and heating were more vulnerable to soaring gas prices. Households were more affected in countries where income per person is lower and therefore energy makes up a larger share of consumption baskets. Inflation rates in the euro area ranged from just under 6% in France to nearly 20% in the Baltic countries (see Graph 3.7).

The cost of the terms-of-trade shock to domestic society varied substantially across the EU. The difference in exposure to the war in Ukraine and energy dependencies explain the differing effects on real incomes across the EU. For most euro area countries, the terms-of-trade shock has reduced real income by between 1% and 4% of GDP. However, the variation has been large at the extremes. Lithuania saw a deterioration of nearly 7%, while others, such as Greece, actually profited from the shift in the terms-of-trade (see Graph 3.8).

⁽³²⁾ [Eurostat \(2022a\)](#). 'Energy statistics - an overview'

⁽³³⁾ [Eurostat \(2022b\)](#). 'EU energy mix and import dependency'

⁽³⁴⁾ See e.g. EIB report 'How bad is the Ukraine war for the European recovery?' or 'Box I.2.2' in the European Commission 2022 spring forecast.

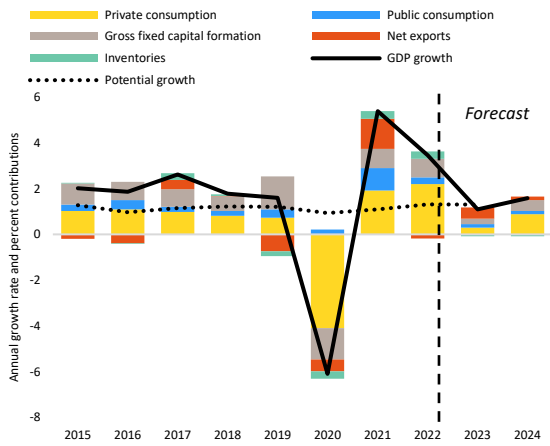
Some countries were able to lessen the impact of rising import prices by raising export prices. Import prices ratcheted up by between 10% and 30% during 2022 not only due to higher energy costs but also other imported products becoming more expensive. Some countries produce these goods domestically as well, which benefited local exporters. Moreover, some exporting companies were able to pass on higher input prices to foreign customers, depending on the price elasticity of their product and their market position. The rise in export prices offset close to two thirds of the import price effect for most countries (see Graph 3.9). Moreover, import volumes shrank due to supply-chain disruptions and higher prices, which in general alleviated the impact of the terms-of-trade on real incomes.

The loss in real wages due to the terms-of-trade shock differed greatly across Member States. Wages increased substantially during 2022 in nominal terms but not enough to compensate for the soaring inflation rates (see Graph 3.10). The severity in the drop of real gross wages compared to the terms-of-trade shock itself has been influenced by the general system of collective bargaining, strength of unions and time of expiry of agreements. In some countries, such as Belgium and Luxembourg, public wages are automatically indexed to the price of a consumption basket. This indexation shields employees from some of the loss in real wages but creates challenges in terms of international competitiveness.

The fiscal response to the energy price shock varied significantly across countries. The cost of energy support measures taken in 2022 ranged from below 0.5% of GDP to just over 2% of GDP (see Graph 3.11). Countries that faced a steeper deterioration of real incomes did not necessarily provide larger fiscal support in the form of energy support measures to their households and companies. Moreover, available fiscal space seems to have played a lesser role in constraining fiscal responses. Rather idiosyncratic factors and preferences drove most of the difference across Member States.

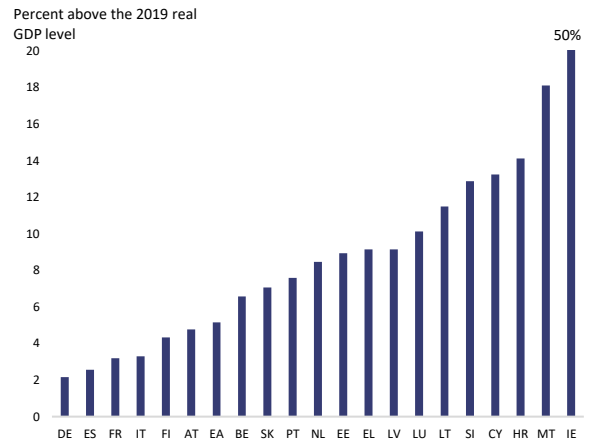
THE MACROECONOMIC OUTLOOK

Graph 1.1: GDP growth and contributions, euro area



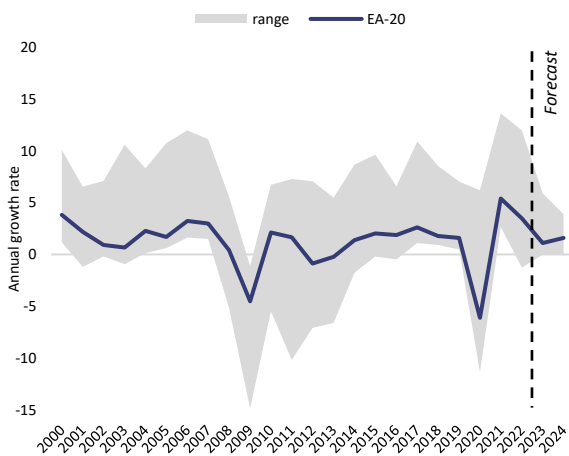
Source: European Commission.

Graph 1.2: Gap to pre-pandemic annual real GDP, 2024



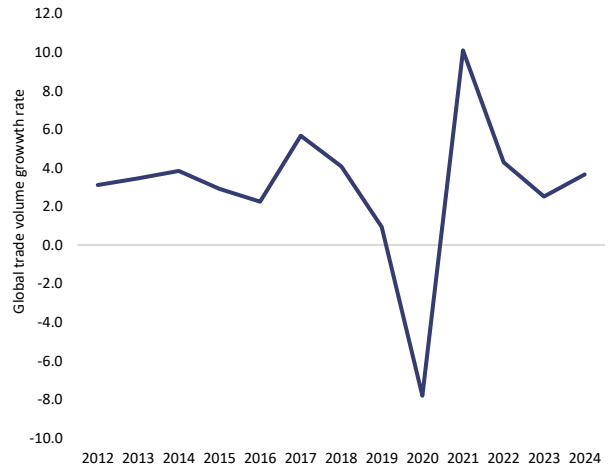
Source: European Commission.

Graph 1.3: Differences in GDP growth in the euro area



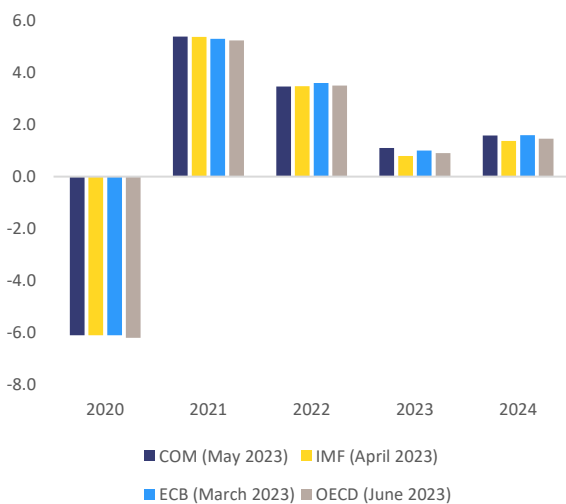
Source: European Commission.

Graph 1.4: Global trade growth



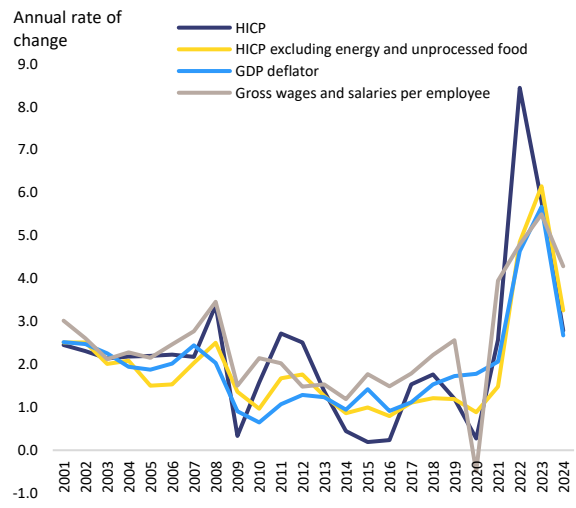
Source: IMF World Economic Outlook.

Graph 1.5: Euro area real GDP



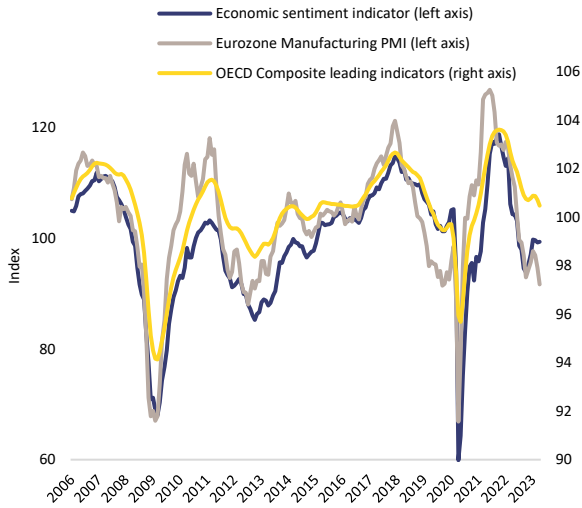
Source: European Commission, OECD, IMF and ECB.

Graph 1.6: Inflation and wages, euro area



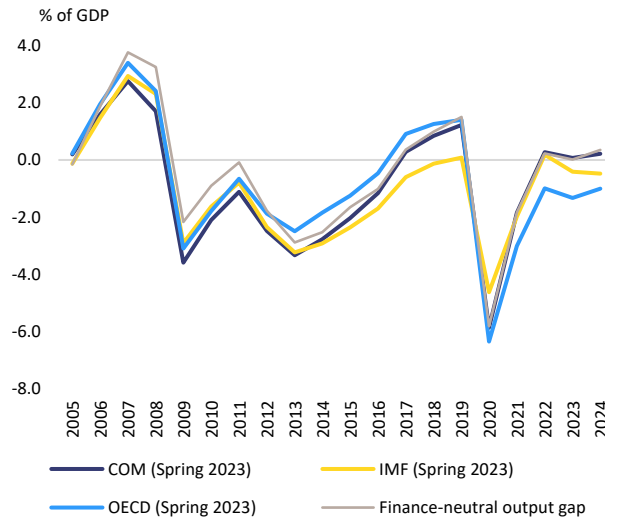
Source: European Commission.

Graph 1.7: Economic survey indicators, euro area



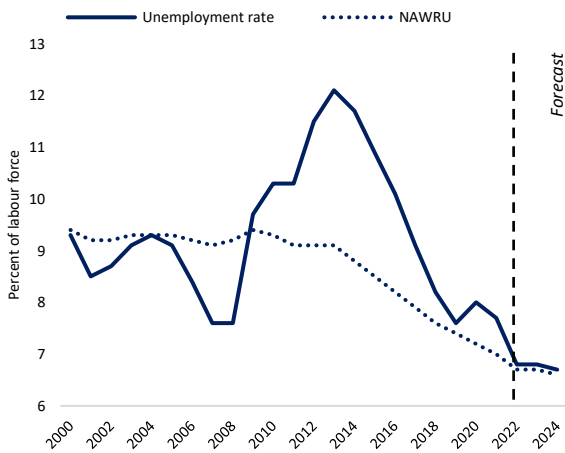
Source: European Commission, OECD, IHS Markit.
Notes: Manufacturing PMI scaled by two for visualisation.

Graph 1.8: Output gap, euro area



Source: European Commission, OECD, IMF.
Notes: (1) OECD data only includes OECD members, thus 17 euro area Member States (excl. Malta and Cyprus); (2) publication dates OECD (June 2023), COM (May 2023), IMF (April 2023); (4) The finance-neutral output gap is derived from an extended HP filter that takes into account short-term real interest rates, credit growth and house price inflation.

Graph 1.9: Unemployment rate, euro area



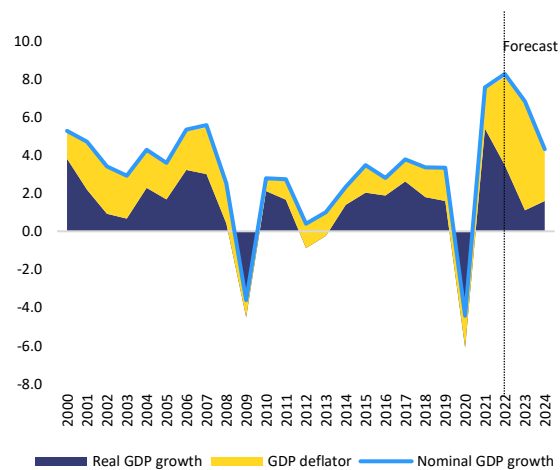
Source: European Commission.
Notes: NAWRU refers to the non-accelerating wage rate of unemployment.

Graph 1.10: Employment and total hours worked



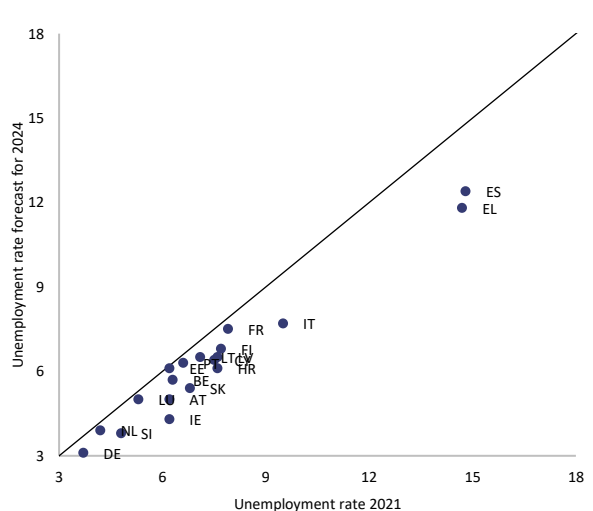
Source: European Commission.

Graph 1.11: Nominal and real GDP growth, euro area



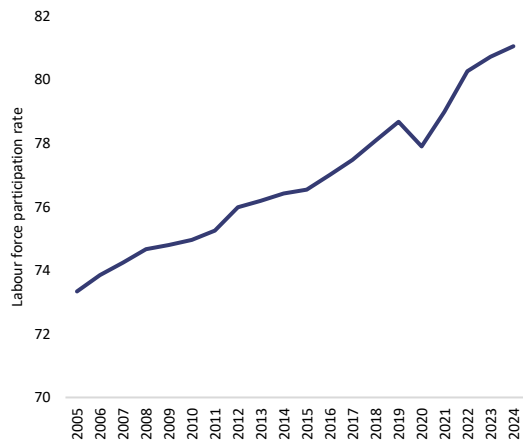
Source: European Commission.

Graph 1.12: Unemployment across Member States



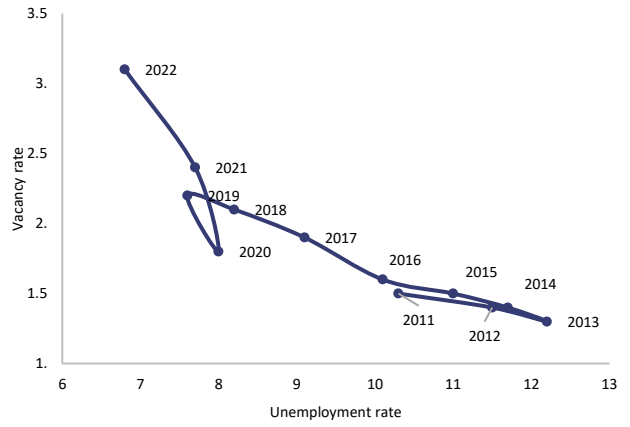
Source: European Commission.

Graph 1.13: Euro area labour force participation rate



Source: European Commission
 Notes: Age group 15 to 64 years.

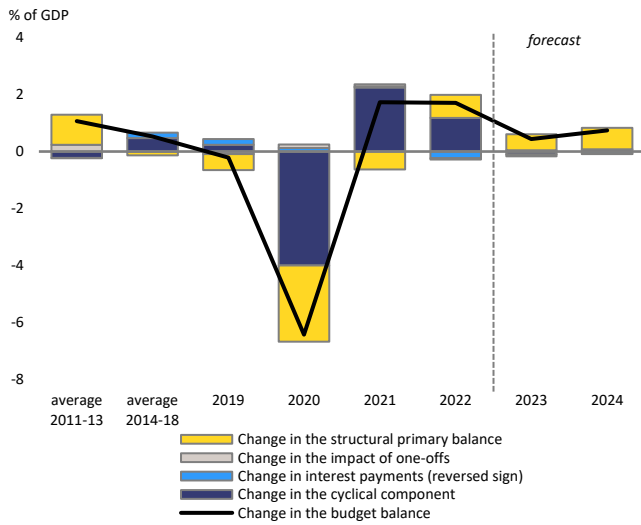
Graph 1.14: Euro area Beveridge curve



Source: Eurostat.
 Notes: The Beveridge curve depicts the relationship between the vacancy rate and unemployment rate.

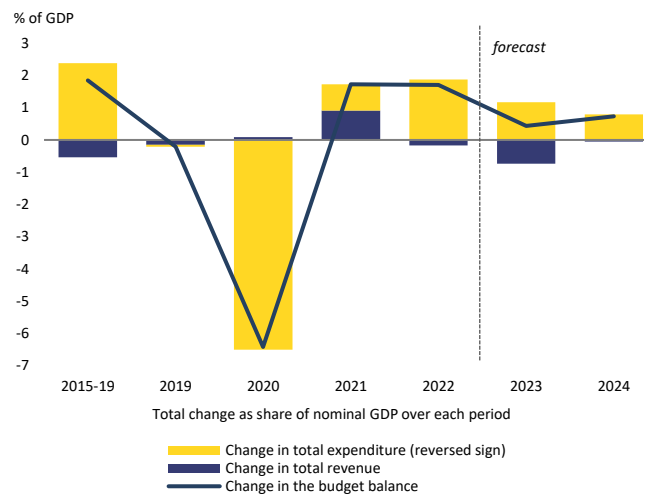
FISCAL POLICY DEVELOPMENTS

Graph 2.1: Drivers of the change in the general government budget balance; euro area aggregate



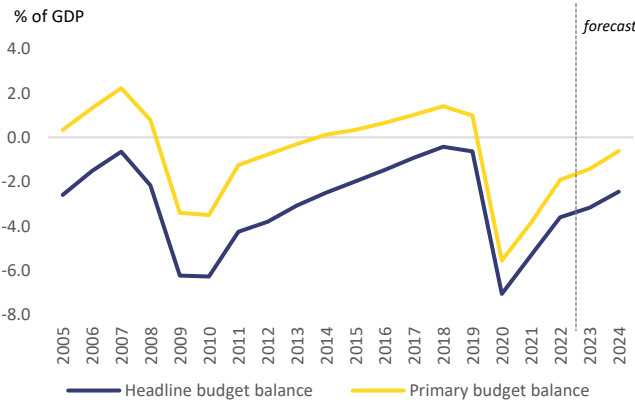
Source: European Commission.
 Note: (1) A decrease in interest payments is shown as an improvement in the headline balance.

Graph 2.2: Government revenue and expenditure; euro area aggregate



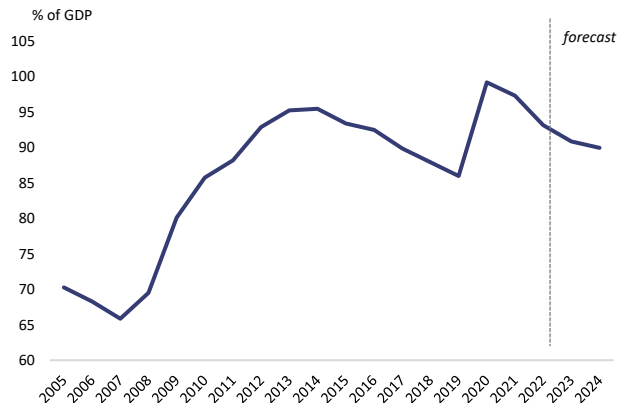
Source: European Commission.

Graph 2.3: Headline budget balance, euro area aggregate



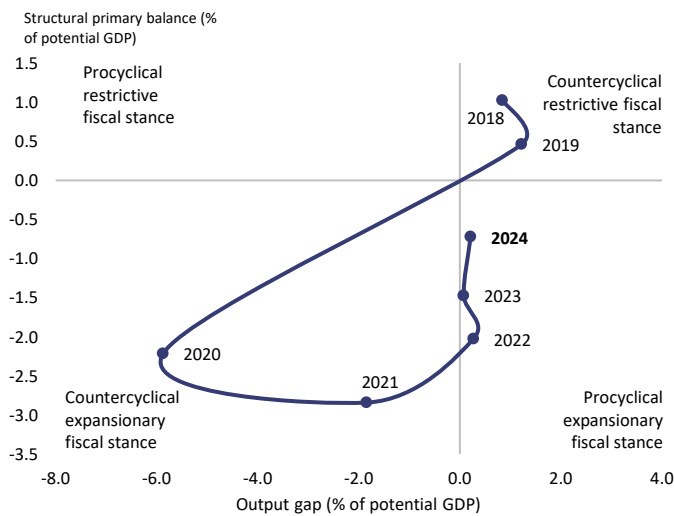
Source: European Commission.
 Notes: Primary budget balance excludes interest expenditure.

Graph 2.4: Euro area debt



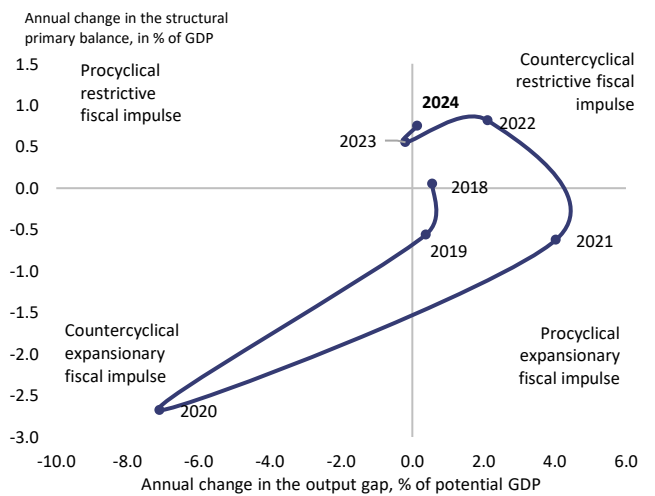
Source: European Commission.

Graph 2.5: Fiscal stance, the structural primary balance; euro area aggregate



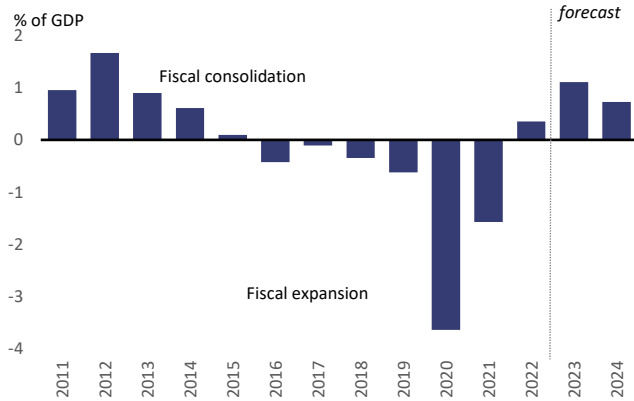
Source: European Commission.

Graph 2.6: Fiscal impulse, change of the structural primary balance, euro area aggregate



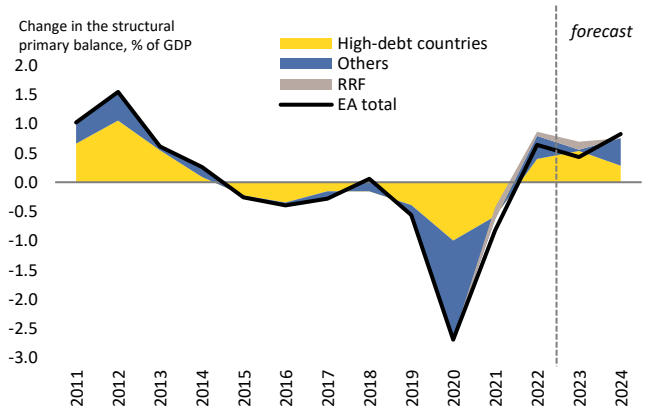
Source: European Commission.

Graph 2.7: Fiscal impulse as measured by net government expenditure growth relative to medium-term potential growth; euro area aggregate



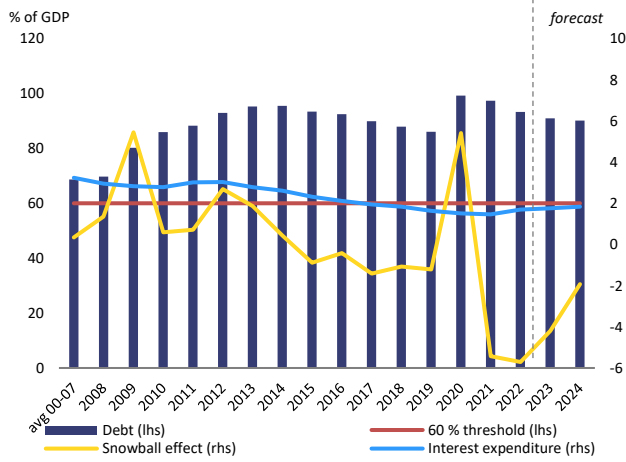
Source: European Commission, own calculations.
Notes: The graph shows the difference between net expenditure growth and medium-term potential growth (see Glossary); it is multiplied by the share of expenditure in GDP to be expressed in % of GDP. If net expenditure growth exceeds medium-term potential growth, the fiscal impulse is considered expansionary.

Graph 2.8: Contributions of countries to the aggregate fiscal impulse



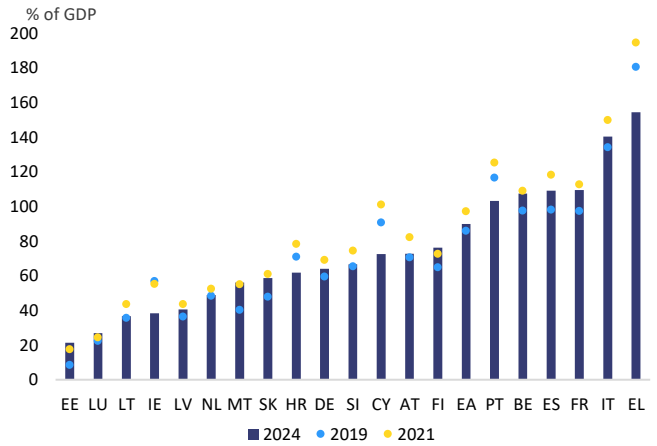
Source: European Commission.
Notes: The group of high-debt countries includes the euro area countries with a debt-to-GDP ratio above 90% in 2022: Belgium, Greece, Spain, France, Italy, and Portugal. Their share in the euro area GDP is 51%. Others: the remaining countries of the euro area.

Graph 2.9: Government debt developments; euro area aggregate



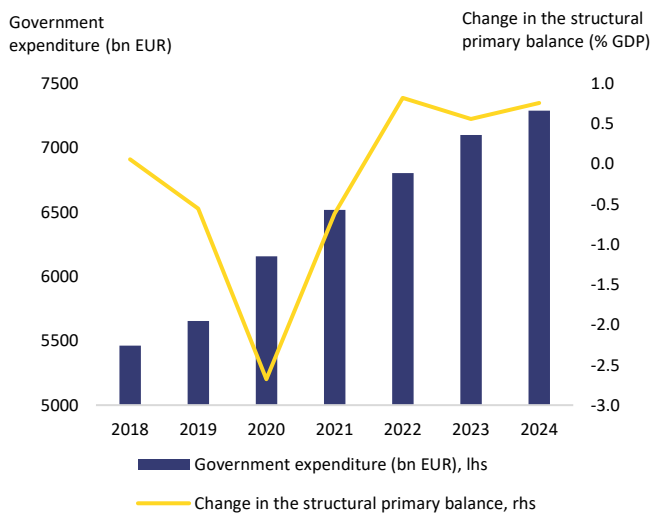
Source: European Commission.
Notes: The snowball effect combines the impact of interest expenditure (blue area) and of nominal GDP growth on the debt-to-GDP ratio: if GDP does not grow sufficiently fast to offset the cost of servicing debt, the debt ratio increases.

Graph 2.10: Government debt levels



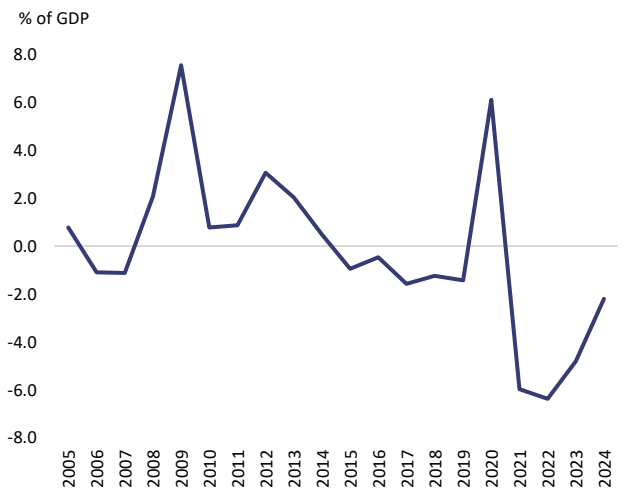
Source: European Commission, own calculations.

Graph 2.11: Euro area government expenditure and change in the structural primary budget balance



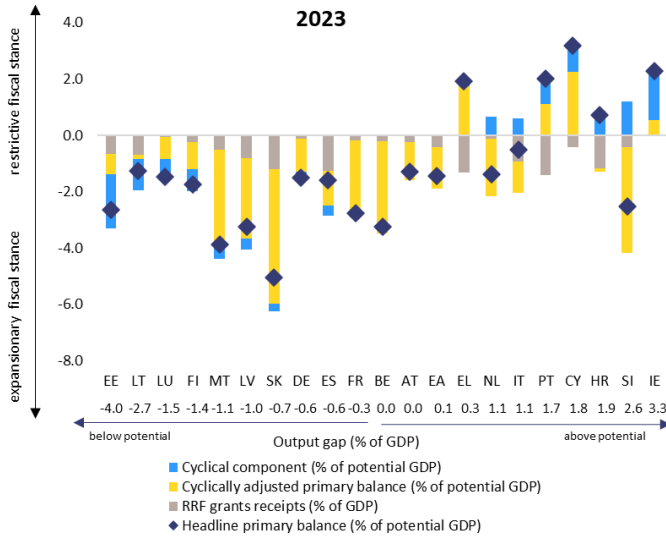
Source: European Commission.

Graph 2.12: Interest rate and growth rate differential (r-g)



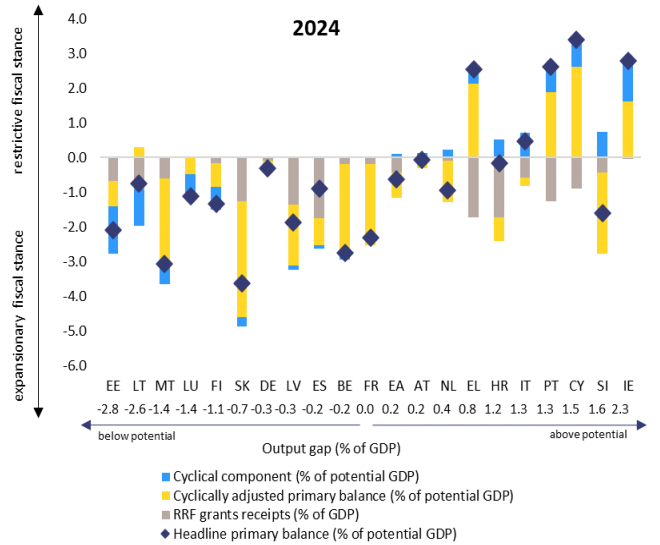
Source: European Commission.

Graph 2.13: Fiscal stance and cyclical conditions across euro area Member States in 2023



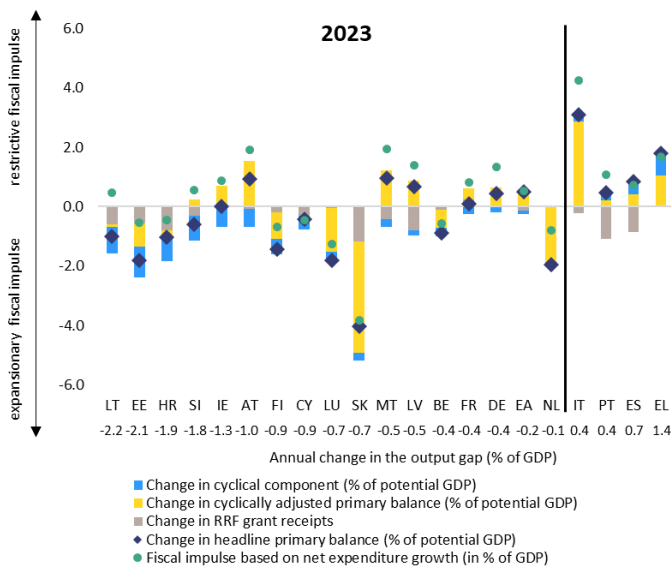
Source: European Commission.

Graph 2.14: Fiscal stance and cyclical conditions across euro area Member States in 2024



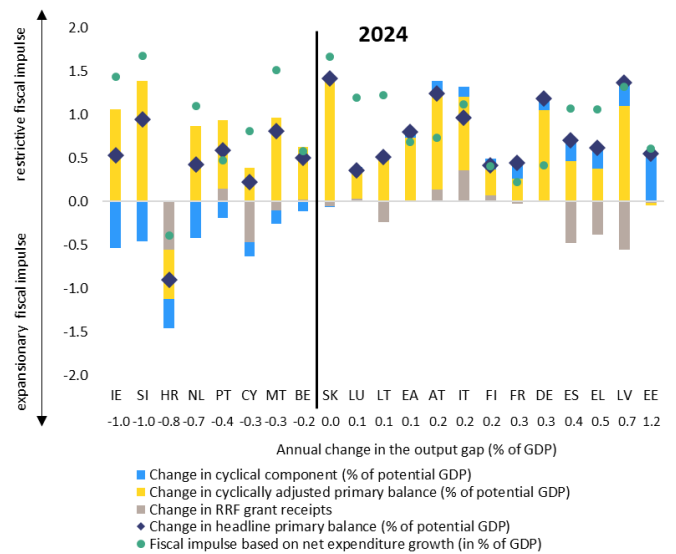
Source: European Commission.

Graph 2.15: Fiscal impulse and cyclical conditions across euro area Member States in 2023



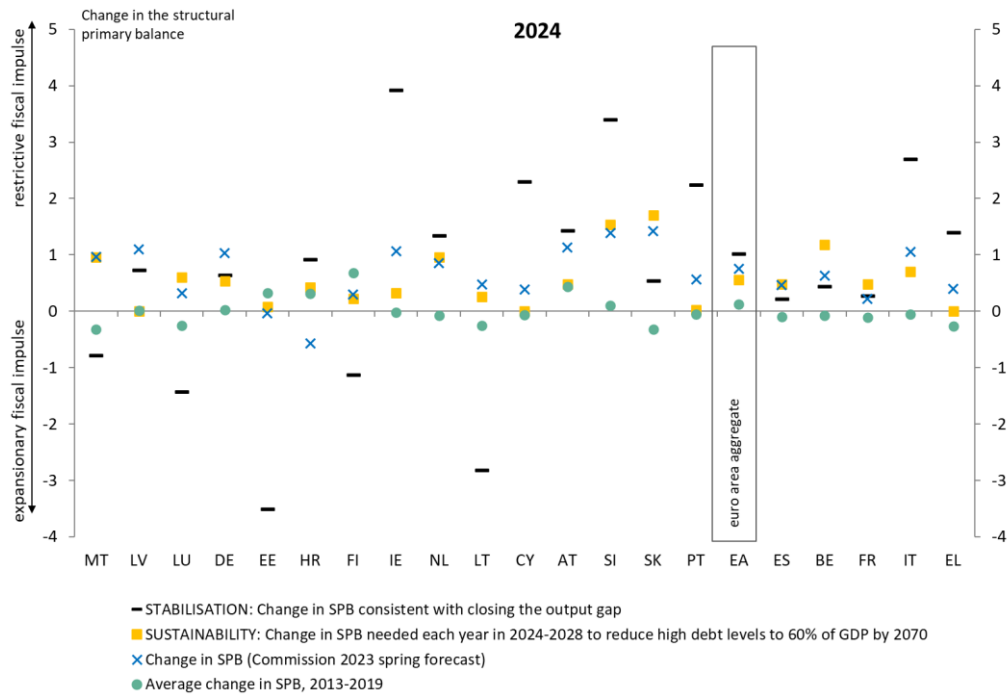
Source: European Commission.

Graph 2.16: Fiscal impulse and cyclical conditions across euro area Member States in 2024



Source: European Commission.

Graph 2.17: Overview: Expected national and aggregate fiscal impulse, stabilisation and sustainability – numbers do not yet reflect the draft budgetary plans of euro area Member States.



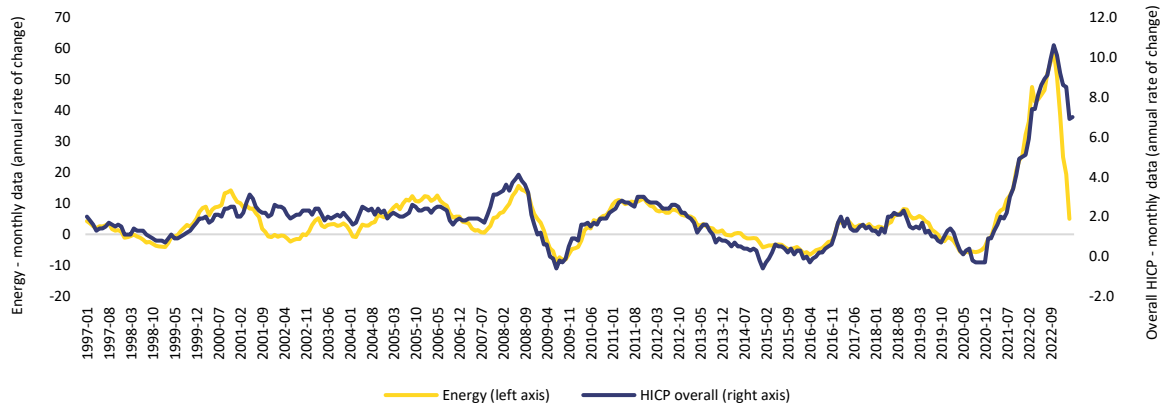
Source: European Commission, own calculations.

Notes

- (1) Countries are ordered by increasing sustainability needs.
- (2) Stabilisation: a neutral fiscal impulse (i.e. letting automatic fiscal stabilisers operate without any additional discretionary measures) is appropriate when the output gap recently changed signs or is expected to narrow at a sufficient pace. If not, the stabilisation point shows the fiscal impulse consistent with a reduction of the output gap by 100% compared to its 2023 level, using a uniform fiscal multiplier of 0.8.
- (3) The new S1 indicator estimates the adjustment in the structural primary balance relative to a set baseline projection, which ensures that the debt-to-GDP ratio falls below 60% by 2070. The Commission's S1 indicator has been divided by 5 to stretch its required fiscal effort over 5 years. Estimates include the costs of ageing.
- (4) In countries where S1 is negative, debt is already below 60% of GDP or expected to fall below it by 2070, therefore no additional consolidation is needed.
- (5) The sustainability estimate for the euro area is approximated by weighing countries by debt levels (in euro).
- (6) Data for the stabilisation and sustainability indicator is based on the DSM 2022 and the Commission's spring forecast 2023.

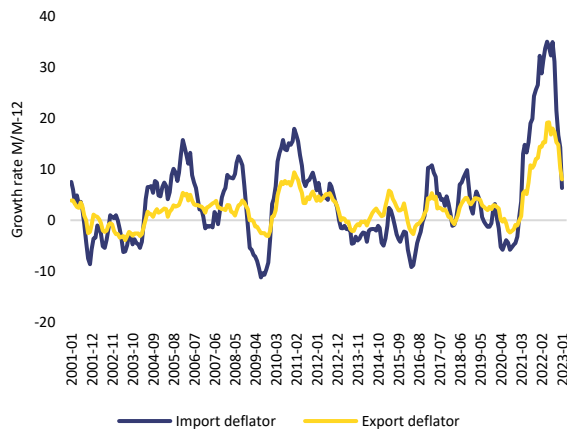
SPECIAL SECTION

Graph 3.1: Consumer and energy inflation, euro area



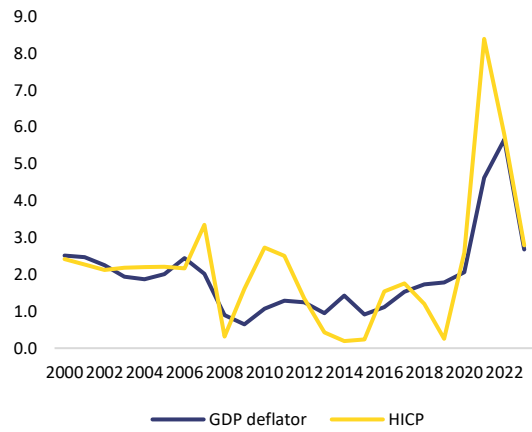
Source: EFB based on Eurostat data.

Graph 3.2: Change in import and export prices, euro area



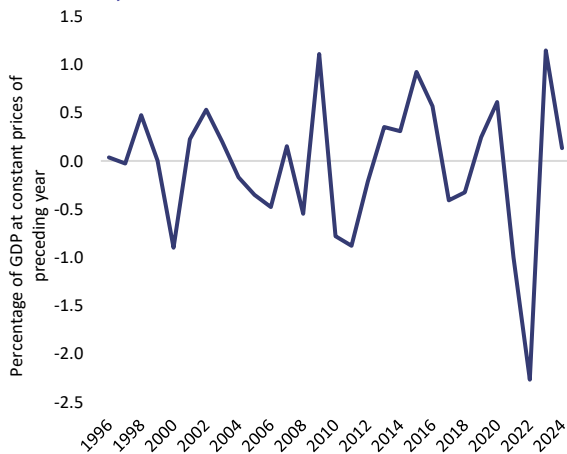
Source: EFB based on Eurostat data.

Graph 3.3: Change in consumer price index and GDP deflator, euro area



Source: EFB based on European Commission data.

Graph 3.4: Impact of terms-of-trade goods and services on real income, euro area



Source: EFB based on European Commission data.

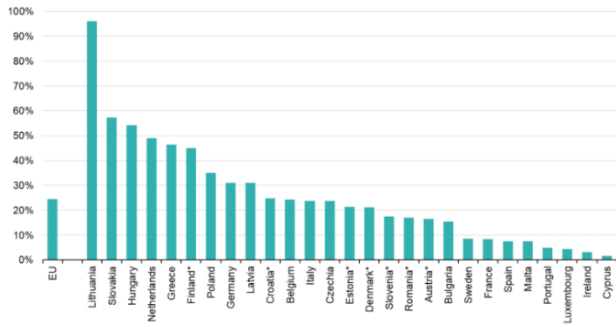
Notes: Derived as nominal export of goods and services divided by the import deflator minus real exports. The change of this term compared to the previous period is divided by real GDP to estimate the impact of the terms-of-trade on real income.

Graph 3.5: Change in real wage, euro area



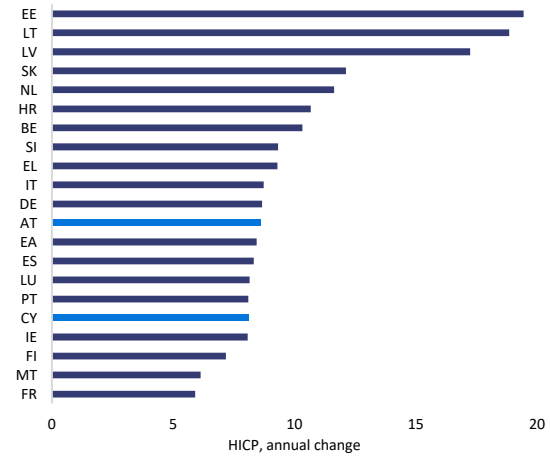
Source: EFB based on European Commission data.

Graph 3.6: Imports from Russia as share of gross available energy, 2020



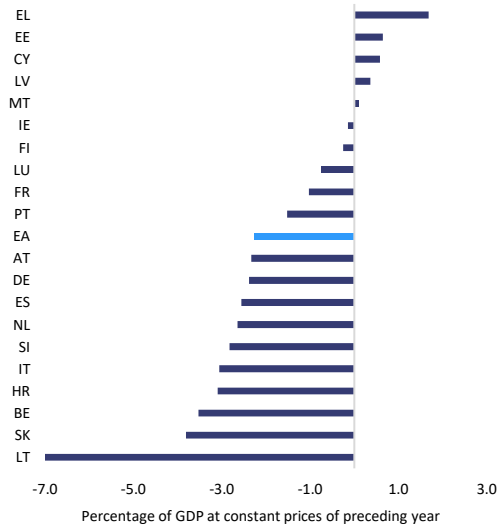
Source: Eurostat.
Note: Estimates non-reported data for countries with *.

Graph 3.7: Harmonised consumer price inflator (HICP), 2022



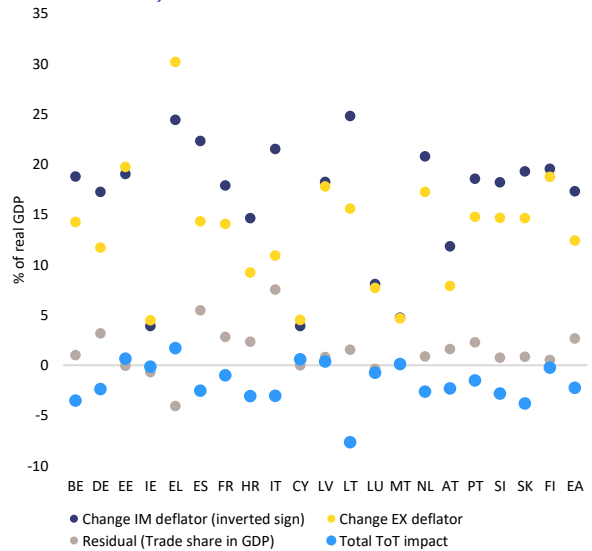
Source: EFB based on European Commission data.

Graph 3.8: Impact of the terms-of-trade shock on real income across Member States, 2022



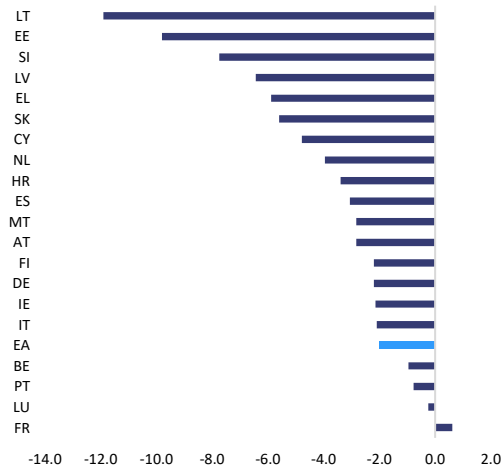
Source: EFB based on European Commission data.
Notes: Derived as nominal export divided by the import deflator minus real exports. The change of this term compared to the previous period is divided by real GDP to estimate the impact of the terms-of-trade on real income.

Graph 3.9: Breakdown of the terms-of-trade shock across Member States, 2022



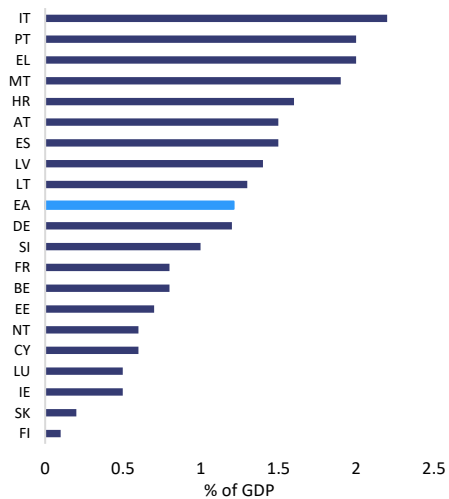
Source: EFB based on European Commission data.

Graph 3.10: Percentage change in real gross wages across countries, 2022



Source: EFB based on European Commission data.

Graph 3.11: Total net costs of energy measures, % of GDP, 2022



Source: EFB based on European Commission data.

Key indicators for the euro area

| Output | | LTA ⁽¹⁾ | 2019 | 2020 | 2021 | 2022 | 22Q1 | 22Q2 | 22Q3 | 22Q4 | 23Q1 |
|--|------------------------------|--------------------|-------|-------|-------|-------|-------|-------|--------|-------|-------|
| Economic sentiment | <i>Indicator</i> | 99.8 | 103.5 | 88.0 | 110.7 | 101.8 | 111.2 | 103.9 | 97.0 | 95.3 | 99.5 |
| Gross domestic product | <i>% ch. on prev. period</i> | | | | | | -3.0 | 2.6 | 0.1 | 1.8 | -3.2 |
| | <i>% ch. on prev. year</i> | 1.5 | 1.6 | -6.1 | 5.3 | 3.5 | 5.6 | 4.4 | 2.5 | 1.5 | 1.2 |
| Labour productivity | <i>% ch. on prev. period</i> | | | | | | -2.6 | 1.1 | -0.5 | 2.1 | -3.0 |
| | <i>% ch. on prev. year</i> | 0.6 | 0.2 | -4.7 | 3.8 | 1.1 | 2.5 | 1.6 | 0.6 | -0.1 | -0.4 |
| Private consumption | | LTA ⁽¹⁾ | 2019 | 2020 | 2021 | 2022 | 22Q1 | 22Q2 | 22Q3 | 22Q4 | 23Q1 |
| Consumer confidence | <i>Balance⁽²⁾</i> | -10.4 | -6.8 | -14.2 | -7.5 | -21.9 | -13.7 | -22.7 | -27.0 | -24.4 | -19.6 |
| Retail confidence | <i>Balance⁽²⁾</i> | -7.9 | -0.2 | -12.6 | -1.8 | -3.8 | 1.6 | -5.1 | -6.9 | -4.8 | -0.8 |
| Private consumption | <i>% ch. on prev. period</i> | | | | | | 0.3 | 0.9 | 1.3 | -1.0 | -0.3 |
| | <i>% ch. on prev. year</i> | 1.2 | 1.4 | -7.8 | 4.0 | 4.5 | 8.4 | 5.8 | 2.7 | 1.4 | 0.8 |
| Retail sales | <i>% ch. on prev. period</i> | | | | | | -13.3 | 4.3 | -0.2 | 7.2 | -13.1 |
| | <i>% ch. on prev. year</i> | 1.1 | 2.5 | 0.3 | 4.8 | 0.2 | 5.3 | 0.4 | -1.0 | -3.2 | -3.0 |
| Investment | | LTA ⁽¹⁾ | 2019 | 2020 | 2021 | 2022 | 22Q1 | 22Q2 | 22Q3 | 22Q4 | 23Q1 |
| Capacity utilisation | <i>Level (%)</i> | 80.9 | 82.2 | 74.5 | 81.4 | 82.1 | 82.4 | 82.5 | 82.3 | 81.4 | 81.0 |
| Production expectations (manufacturing) | <i>Balance⁽²⁾</i> | 7.9 | 5.1 | -1.3 | 19.7 | 9.9 | 16.8 | 9.1 | 6.4 | 7.2 | 10.4 |
| Gross fixed capital formation (3) | <i>% ch. on prev. period</i> | | | | | | -0.6 | 1.0 | 4.0 | -3.5 | 0.6 |
| | <i>% ch. on prev. year</i> | 1.7 | 6.6 | -6.2 | 4.6 | 3.8 | 3.9 | 3.0 | 7.8 | 0.6 | 1.9 |
| - equipment investment | <i>% ch. on prev. period</i> | | | | | | 1.8 | 1.5 | 3.2 | -1.4 | 1.8 |
| | <i>% ch. on prev. year</i> | 2.6 | 1.8 | -12.1 | 10.4 | 4.3 | 1.7 | 2.2 | 8.1 | 5.1 | 5.2 |
| - construction investment | <i>% ch. on prev. period</i> | | | | | | 2.1 | 0.1 | -0.9 | -0.9 | 1.3 |
| | <i>% ch. on prev. year</i> | 0.5 | 3.1 | -4.3 | 6.5 | 2.2 | 4.8 | 2.2 | 1.6 | 0.3 | -0.5 |
| Change in stocks | <i>Contrib. to GDP (pp)</i> | 0.6 | 0.8 | 0.4 | 1.0 | 1.6 | 1.9 | 1.7 | 1.8 | 1.0 | 0.5 |
| Labour market | | LTA ⁽¹⁾ | 2019 | 2020 | 2021 | 2022 | 22Q1 | 22Q2 | 22Q3 | 22Q4 | 23Q1 |
| Employment expectations (manufacturing) | <i>Balance⁽²⁾</i> | -6.7 | -1.0 | -12.4 | 8.3 | 10.2 | 15.1 | 10.9 | 8.1 | 6.9 | 7.0 |
| Employment expectations (services) | <i>Balance⁽²⁾</i> | 6.2 | 9.6 | -5.6 | 8.6 | 11.8 | 13.6 | 13.3 | 10.4 | 9.9 | 12.2 |
| Employment | <i>% ch. on prev. period</i> | | | | | | 0.6 | 0.4 | 0.3 | 0.3 | 0.6 |
| | <i>% ch. on prev. year</i> | 0.8 | 1.3 | -1.5 | 1.4 | 2.2 | 3.1 | 2.7 | 1.8 | 1.5 | 1.6 |
| Employment (000) | <i>ch. on prev. period</i> | | 8647 | -9979 | 8972 | 14634 | 904 | 596 | 496 | 474 | 1007 |
| Compensation of employees (per head, nominal) | <i>% ch. on prev. period</i> | | | | | | 1.1 | 0.8 | 1.2 | 1.7 | 1.4 |
| | <i>% ch. on prev. year</i> | 2.2 | 2.3 | -0.5 | 4.1 | 4.5 | 4.6 | 4.5 | 3.9 | 4.9 | 5.2 |
| Unemployment rate | <i>% of lab. force</i> | | 7.6 | 8.0 | 7.8 | 6.7 | 6.8 | 6.7 | 6.8 | 6.7 | |
| Unemployment (000) | <i>ch. on prev. period</i> | | -3930 | 1630 | -781 | -5800 | -58 | -709 | 139 | 3 | |
| International transactions | | LTA ⁽¹⁾ | 2019 | 2020 | 2021 | 2022 | 22Q1 | 22Q2 | 22Q3 | 22Q4 | 23Q1 |
| World trade | <i>% ch. on prev. period</i> | | | | | | 0.1 | 0.6 | 1.1 | -2.0 | -0.9 |
| | <i>% ch. on prev. year</i> | | -0.4 | -5.1 | 10.4 | 3.2 | 4.3 | 3.7 | 5.2 | -0.2 | -1.2 |
| Export order books | <i>Balance⁽²⁾</i> | -16.9 | -13.1 | -32.7 | -1.8 | -0.3 | 7.0 | 2.9 | -3.3 | -7.9 | -6.7 |
| Trade balance (merchandise) | <i>Billion EUR</i> | | 211 | 226.2 | 109.9 | -327 | -48.7 | -96.9 | -124.6 | -56.9 | 6.6 |
| Exports of goods and services | <i>% ch. on prev. period</i> | | | | | | 1.7 | 1.8 | 1.2 | -0.2 | -0.1 |
| | <i>% ch. on prev. year</i> | 4.6 | 2.9 | -9.3 | 11.3 | 7.4 | 9.1 | 8.3 | 7.7 | 4.6 | 2.7 |
| Imports of goods and services (3) | <i>% ch. on prev. period</i> | | | | | | 0.1 | 1.8 | 4.1 | -2.5 | -1.3 |
| | <i>% ch. on prev. year</i> | 4.5 | 4.9 | -8.6 | 9.1 | 8.5 | 10.1 | 8.9 | 11.7 | 3.4 | 2.0 |
| Prices | | LTA ⁽¹⁾ | 2019 | 2020 | 2021 | 2022 | 22Q1 | 22Q2 | 22Q3 | 22Q4 | 23Q1 |
| Headline inflation (HICP) | <i>% ch. on prev. year</i> | | 1.2 | 0.3 | 2.6 | 8.3 | 6.1 | 8.1 | 9.3 | 9.9 | 8.0 |
| Core inflation | <i>% ch. on prev. year</i> | | 1.2 | 0.9 | 1.5 | 4.8 | 2.8 | 4.3 | 5.5 | 6.6 | 7.4 |
| Monetary and financial indicators | | LTA ⁽¹⁾ | 2019 | 2020 | 2021 | 2022 | 22Q1 | 22Q2 | 22Q3 | 22Q4 | 23Q1 |
| Nominal interest rates (3-month) | <i>Level</i> | | -0.35 | -0.42 | -0.54 | 0.34 | -0.52 | -0.35 | 0.48 | 1.77 | 2.63 |
| Nominal interest rates (10-year) | <i>Level</i> | | -0.25 | -0.51 | -0.37 | 1.14 | 0.10 | 1.05 | 1.30 | 2.11 | 2.31 |
| ECB repo rate | <i>Level</i> | | 0.0 | 0.0 | 0.0 | 2.5 | 0.0 | 0.0 | 0.5 | 2.5 | 3.5 |
| Bilateral exchange rate USD/EUR | <i>Level</i> | | 1.12 | 1.14 | 1.18 | 1.05 | 1.12 | 1.07 | 1.01 | 1.02 | 1.07 |
| | <i>% ch. on prev. period</i> | | | | | | -1.9 | -5.1 | -5.5 | 1.3 | 5.1 |
| | <i>% ch. on prev. year</i> | | -5.2 | 1.9 | 3.7 | -10.9 | -6.9 | -11.6 | -14.6 | -10.8 | -4.4 |
| Nominal effective exchange rate | <i>% ch. on prev. period</i> | | | | | | 0.1 | -0.5 | -1.2 | 1.8 | |
| | <i>% ch. on prev. year</i> | | -1.5 | 2.9 | 2.2 | -0.6 | 0.0 | -1.1 | -1.5 | 0.2 | |

Sources: European Commission, ECB, CPB Netherlands Bureau for Economic Policy Analysis.

Notes: Data in the table have been taken from different sources available until 9 June 2022 and at different moments in time. (1) LTA = Long-term average (since 1990 or earlier if available). (2) Balance: the difference between positive and negative answers, in percentage points of total answers.

GLOSSARY

Automatic fiscal stabilisers: the way government revenue and spending react in a stabilising manner to fluctuations of output without deliberate government action. As a result, the budget balance as a percent of GDP tends to improve in years of high growth and deteriorate during economic slowdowns.

Country-specific recommendations (CSRs): policy guidance tailored to each EU Member State based on the provisions of the Stability and Growth Pact and the macroeconomic imbalance procedure. The recommendations are put forward by the European Commission in May each year, then discussed among Member States in the Council, endorsed by EU leaders at a summit in June, and formally adopted by the finance ministers in July.

Discretionary fiscal policy: change in the budget balance and in its components under the control of government. It is usually measured as the residual of the change in the budget balance after the budgetary impact of automatic stabilisers and interest payments has been excluded (see also ‘fiscal stance’).

Draft budgetary plans (DBPs): governments submit DBPs to the Commission and the Council to ensure the coordination of fiscal policies among Member States who have the euro as their currency and because the EU Treaty recognises economic policy as ‘a matter of common concern’. They submit their DBPs for the following year between 1 and 15 October. The requirement was set in 2013 with the two-pack reform of the Stability and Growth Pact.

Expenditure benchmark: a mechanism applied under the preventive arm of the Stability and Growth Pact imposing an upper limit on the growth rate of government primary expenditure net of discretionary revenue measures. The objective of the benchmark is to ensure that a country stays at its medium-term budgetary objective (MTO) or on the adjustment path towards it (see also net expenditure).

Fiscal impulse: a measure of the direction and extent of discretionary fiscal policy. In this document, it is defined as the annual change in the structural primary budget balance. It is thus the change in the fiscal stance (see also ‘fiscal stance’). When the change is positive, the fiscal impulse is said to be restrictive; when the change is negative, it is said to be expansionary.

Fiscal space: leeway to run an expansionary fiscal policy. While there is no generally accepted definition, in this document a country is considered to have fiscal space in year t if its structural balance in year $t-1$ is estimated above its medium-term budgetary objective (MTO). Barring other considerations, the country may use this fiscal space, i.e. let its structural balance deteriorate at most until it reaches its MTO.

Fiscal stance: a measure of the direction and extent of discretionary fiscal policy. In this document, it is defined as the structural primary budget balance. When the balance is positive, the fiscal stance is said to be restrictive; when the stance is negative, it is said to be expansionary.

General escape clause: See severe economic downturn clause.

Medium-term budgetary objective (MTO): under the Stability and Growth Pact, stability programmes and convergence programmes present a medium-term objective for the budgetary position. It is country-specific to take into account the diversity of economic and budgetary developments and fiscal risks to the sustainability of public finances. It is defined in structural terms (see ‘structural balance’).

Net expenditure: primary government expenditure net of certain items not directly under the control of government (expenditure backed by EU funds and the cyclical component of unemployment benefit expenditure) and using investment expenditure smoothed over 4 years. It is also net of discretionary revenue measures and revenues mandated by law and corrected for the impact of one-offs (see also ‘expenditure benchmark’).

Output gap: the difference between actual output and estimated potential output at a particular point in time. A business cycle typically includes a period of positive output gaps and a period of negative output gaps. When the output gap is closed, the economy is in line with its potential level (see ‘potential GDP’). Observations indicate that a standard business cycle usually lasts up to 8 years, suggesting that the output gap is typically expected to close roughly every 4 years.

Potential GDP: the level of real GDP in a given year that is consistent with a stable rate of inflation. If actual output rises above its potential level, constraints on capacity begin to bind and inflationary pressures build; if output falls below potential,

resources are lying idle and inflationary pressures abate (see also ‘output gap’).

S1 indicator: a long-term sustainability indicator used by the European Commission in its debt sustainability analysis. It measures the permanent adjustment in the structural primary balance relative to a set baseline projection, which ensures that the debt-to-GDP ratio falls below 60% by 2070.

Severe economic downturn clause: in the public debate misleadingly referred to as the ‘general escape clause’, it was created in 2011 as part of the six-pack reform of the Stability and Growth Pact. It allows for additional and temporary flexibility with the normal requirements of the preventive and corrective arm of the Pact in the event of a severe economic downturn for the euro area or the EU as a whole, provided that this does not endanger fiscal sustainability in the medium term. A severe economic downturn is defined using average annual real GDP growth or as an accumulated loss of output relative to the potential output for a prolonged period of time.

Stabilisation: economic policy intervention to bring actual output closer to potential output. In the Economic and Monetary Union, this is expected to be achieved, in normal economic times, through the ECB’s monetary policy (for common shocks) and national automatic fiscal stabilisers (for country-specific shocks). When this is not sufficient, discretionary fiscal policy can also play a role.

Stability and convergence programmes (SCPs): Every year in April, EU Member States are required to set out their fiscal plans for the next 3 years and to submit them for assessment to the European Commission and the Council. This exercise is based on the economic governance rules under the Stability and Growth Pact. Euro area countries submit stability programmes; non-euro area countries convergence programmes.

Structural balance: the headline budget balance corrected for the impact of the economic cycle and net of one-off and other temporary measures. The structural balance gives a measure of the underlying trend in the budget balance.

Structural primary balance: the structural budget balance net of interest payments.

Sustainability of public finances: the ability of a government to service its debt. From a purely theoretical point of view, this basically assumes that

the government debt level does not grow faster than the interest rate. While conceptually intuitive, an agreed operational definition of sustainability has proven difficult to achieve. The European Commission uses three indicators of sustainability with different time horizons (S0, S1 and S2) which are complemented by a debt sustainability analysis that includes sensitivity tests on government debt projections and alternative scenarios.

Zero or effective lower bound (ZLB): when the short-term nominal interest rate is at or near zero, the central bank is limited in its capacity to stimulate economic growth by lowering policy rates further. To overcome the constraint imposed by the ZLB, alternative methods to stimulate demand are generally considered, such as asset purchase programmes. The root cause of the ZLB is the issuance of paper currency, effectively guaranteeing a zero nominal interest rate and acting as an interest rate floor. Central banks cannot encourage spending by lowering interest rates because people would hold cash instead.