European Fiscal Board

Assessment of the fiscal stance appropriate for the euro area in 2025

3 July 2024

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Comments on the report should be sent to:

Secretariat of the European Fiscal Board
European Commission
Rue de la Loi 200
Office BERL 2/352
B-1049 Brussels
Email: EFB-SECRETARIAT@ec.europa.eu

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CONTENTS

FOREWORD

Niels Thygesen
Chair of the European Fiscal Board (EFB)

The year 2025 will mark a significant moment in the development of the EU's fiscal framework. The implementation of national fiscal policies in the EU will be organised around a revised set of rules.

The debate leading up to the reform was not easy. It confirmed entrenched positions across countries that seemed difficult to reconcile when the economic governance review began in 2020. While the final compromise comes with welcome innovations, including suggestions also advocated by the EFB since 2019, it fails to simplify the framework and its implementation is marred by uncertainty. The reformed framework still aims to preserve sustainable public finances, this time by taking a more medium-term and country-specific perspective. It also aims at encouraging structural reforms and government investment.

Right after the agreement on the reform, the EU launched preparations to ensure national fiscal policies can be implemented under the new rules as of next year. As policymakers embark on this new journey, the implications for both domestic economies and the euro area are potentially profound and far-reaching. If strictly implemented, the new rules will put high public debt levels on a sustainable path under normal cyclical conditions. Moreover, by anchoring the system on medium-term expenditure paths, it should improve countercyclical fiscal stabilisation. Such an outcome is predicated on the fundamental insight that sustainable public finances are the bedrock on which stabilisation policies can be built.

Apart from improving how national fiscal policies are carried out, the new system is designed to strengthen the overall stability of the euro area. Member States adopting national policies that follow a stable and bespoke path towards sustainable positions can build sufficient buffers to dampen economic downturns along the way. This can make it easier for the European Central Bank (ECB) to effectively achieve its objective of low and stable inflation set out in the Treaty. Sustainable public finances are not only a pre-condition for fiscal stabilisation via national budgets but also for the ECB to fulfil its mandate.

As the EU moves towards a hopefully more effective fiscal architecture, the transition to the new system gives rise to significant concerns. Although the severe economic downturn clause was officially deactivated at the end of 2023, the way EU fiscal surveillance will be implemented in 2024 remains shrouded in uncertainty. The Commission and the Council should proceed with a timely implementation of the excessive deficit procedure. Both institutions should also clarify how they intend to deal with the budgetary slippages currently emerging in several countries in 2024.

In the past few years, government expenditure has accelerated significantly in many euro area countries well beyond the temporary measures taken in response to the Covid crisis and the subsequent energy price hike. Growing demands on the public purse are accompanied by a significant deterioration in several Member States of the attention paid to sustainable public finances. The implication is a structural upward trend in public spending that will need to be addressed.

As a consequence, fiscal support is significantly higher than what the macroeconomic outlook justifies. It may further increase if emerging slippages are not addressed. Against this backdrop, the EFB believes that a sizeable part of the fiscal support should be removed in 2025. Fiscal restraint would be appropriate for the euro area as a whole and lay the groundwork for successfully launching the EU's reformed framework for national fiscal policies in the future.

KEY MESSAGES

- Economic growth in the euro area is projected to pick up in 2025. Private consumption is expected to be the main driver, fuelled by falling inflation, which remains slightly above target, a tight labour market and sustained real wage growth.
- Unless further measures are presented in the draft budgetary plans for 2025 later this year, fiscal support in the euro area is set to remain substantial, well above what is justified by the macroeconomic outlook. In addition, several Member States with very high government debt are exhibiting rapid expenditure growth.
- In several euro-area countries, fiscal deficits in 2024 are forecast to turn out higher than previously expected and recommended. Without clarity on how slippages will be treated, the euro area is likely to enter 2025 with a level of fiscal support that exceeds previous projections.
- Overall, the EFB considers a sizeable restrictive fiscal impulse in 2025 is appropriate, one that addresses the underlying expenditure drift. This would also help preserve the relatively benign assessment of sovereign risks by financial markets.
- Following the political agreement on the economic governance review, national fiscal policies for 2025 are being planned under the revised EU fiscal framework. However, the reference trajectories for Member States will only be made public later this year when governments present their medium-term fiscal-structural plans. Moreover, the recent Commission proposal to delay the adoption of the excessive deficit recommendations sets a precedent, creating uncertainty around the fiscal stance in 2025. Consequently, it is not currently possible to determine whether the combined fiscal policy recommendations and plans will be appropriate for the euro area as a whole.
- The reformed EU fiscal framework seeks to strengthen Member States' debt sustainability, a precondition both for effective fiscal stabilisation at national level and for monetary policy to effectively focus on its price stability mandate. Complying with medium-term net expenditure growth ceilings would improve the stabilisation properties of the reformed framework. Therefore, under the new rules the fiscal impulse should more often become appropriate for the euro area as a whole during normal cyclical fluctuations driven by aggregate demand.

1. Macroeconomic situation and outlook

Economic activity in the euro area is set to pick up speed in 2025. After a marked slowdown in 2023, conditions are favourable for a gradual acceleration in economic activity in 2024 and 2025. Declining inflation, real wage growth and stable employment are expected to drive a rebound in consumer spending. Investment is forecast to benefit from improving credit conditions and the continued deployment of the EU's Recovery and Resilience Facility (RRF). Moreover, external demand is predicted to return to normal levels. The rate of growth of the euro area's real GDP is expected to increase to 1.4% – compared to 0.4% in 2023 and 0.8% in 2024 – broadly in line with current estimates of potential growth. Current forecasts are predicated on the assumption that geopolitical tensions will remain high but do not further exacerbate.

Cross-country growth differences in the euro area are expected to narrow to a record low. Although it was a common shock, the energy price hike in 2022 had a very different impact on economic activity across euro area countries. Differences depended on factors such as the fiscal policy response, the energy mix, trade intensity with Russia or Ukraine, energy intensity of industries and the possibility for domestic exporters to pass on higher energy costs to foreign customers. National and EU efforts to diversify gas suppliers, increase storage levels and boost investment in renewable energy helped reverse the initial shock, mitigating inflationary pressure and the contraction in economic activity. The Commission's 2024 spring forecast suggests that cross-country growth differences in the euro area will narrow in 2025 to historical lows on the back of energy price normalisation (see Graph 1.2).

Private consumption will be the main driver of economic activity. Current economic sentiment indicators still portray a somewhat pessimistic view of prospects, but there has been an improvement in recent months (see Graph 1.6). To the extent that inflation continues to decrease and real wages recover, real disposable income will grow faster in the coming years, stimulating private household spending. The ECB's first interest rate cut on 6 June 2024 can have a favourable impact on business and housing investment. Assuming supply bottlenecks ease and global tensions do not further escalate, global trade is forecast to increase, supporting economic growth in 2025 (see Graph 1.3) ([1]).

Labour markets remain resilient supporting the rebound of private consumption. The remarkable growth in employment seen in recent years is projected to continue in 2025, although at a slower pace. Unemployment is forecast to continue falling and go below current estimates of the non-accelerating wage rate of unemployment (NAWRU) in 2025, reaching another historical low for the euro area. However, the labour market is forecast to be less tight as vacancy rates have started to decline from a high level. Most euro area countries are expected to have lower unemployment rates than in 2021 (see Graph 1.10), even though employment and participation rates are forecast to keep increasing over the forecast horizon (see Graph 1.12).

Inflation is expected to move closer to the ECB target, although risks are tilted to the upside. The Harmonised Index of Consumer Prices (HICP) inflation rate is projected to decrease further due to declining energy prices and the impact of past monetary policy tightening. However, risks of second-round effects via wage growth persist as unit labour costs continue to increase strongly. While most forecasters expect wage growth to gradually fall in the next 2 years some concerns remain. The energy crisis is likely to continue affecting the viability of some businesses, as energy prices are expected to remain above pre-2021 levels. These

([1]) Latest decisions on trade tariffs and similar potential measures in the future may affect this outlook.

scarring effects may have reduced potential output and could affect inflation in the coming years.

International organisations see mainly downside risks to growth. Measures taken to increase energy storage levels and diversify gas sources helped mitigate the risks of future energy shocks. However, for most observers, including international organisations, the conflicts in Ukraine and the Middle East pose a tangible threat to the economic outlook. This, coupled with escalating trade tensions, will dampen external demand and lead to further inflationary pressures. Furthermore, possible supply bottlenecks and second-round effects due to wage increases cannot be excluded. Such factors would weaken growth prospects and produce negative feedback on sovereign bond markets.

2. Fiscal policy developments

Precise language is needed when discussing fiscal policy, especially at this point in time. The EFB's assessment of the fiscal stance evaluates the need for fiscal stabilisation within sustainability constraints. As in previous years, a distinction is made between the fiscal stance and the fiscal impulse ([2]). In line with the relevant literature ([3]), 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 on top of automatic stabilisers. The annual change in the fiscal stance is the fiscal impulse. The fiscal impulse can also be derived from the expenditure benchmark (see Glossary). The distinction between the stance and impulse is particularly important at the present time where a recommended contractionary fiscal impulse coincides with a fiscal stance that remains highly supportive given the macroeconomic environment ([4]).

Although GDP growth is picking up, public finances are projected to remain largely unchanged. Based on unchanged policies, forecasters do not anticipate the euro area budget deficit to significantly improve in 2025. The difference between total government expenditure and revenues is expected at 2.8 % of GDP, broadly unchanged from the previous year. The debt-to-GDP ratio is expected to increase slightly to above 90% of GDP. This outlook is to be assessed against (i) the assumed acceleration of real GDP; and (ii) the expected phasing out of remaining temporary support measures. It points to very dynamic underlying expenditure trends, an issue repeatedly highlighted by the EFB in past reports. Growing demands from the population for higher government expenditure to protect against adverse events in the post-pandemic period are accompanied by a situation in which attention to sustainable public finances has deteriorated significantly in several Member States.

At unchanged policies, discretionary fiscal support is projected to continue to be substantial. Current estimates indicate a contractionary fiscal impulse of only 0.1% of GDP in 2025, which leaves the structural primary budget deficit at 0.8% of GDP. This level of discretionary fiscal support is excessive given (i) the expected economic conditions outlined in the previous section; (ii) the continuing high level of debt in some countries and (iii) the impact of government spending funded by RRF grants, which are netted out in the budget balance ([5]). To secure a meaningful improvement in the underlying fiscal position, the draft budgetary plans for 2025 will have to include new discretionary measures.

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

([3]) See Heller et al. (1986).

([4]) For a more detailed discussion, see the EFB's 2021 report (Box 1) on the assessment of the euro area fiscal stance in 2022.

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

EU fiscal guidance for 2025 is planned to be made public later this year. National fiscal policies for 2025 will be planned and implemented under the reformed EU fiscal framework. Based on its latest macroeconomic forecasts and sustainability analysis, the Commission on 21 June shared reference trajectories with those Member States whose government deficit exceeds 3% of GDP or whose public debt exceeds 60% of GDP. The reference trajectories will only be made public after national governments approve their medium-term fiscal structural plans later this year. Therefore, the EFB's assessment cannot currently conclude whether EU guidance for individual Member States results in an appropriate orientation of fiscal policy for the single currency area as a whole (6).

Delaying guidance on how to end excessive deficits adds uncertainty for fiscal policy in 2025. Since the activation of the severe economic downturn clause in spring 2020, the Commission and the Council have not opened excessive deficits procedures (EDPs) (7), even though the clause does not suspend the EU's fiscal rules and procedures and many countries ran excessive deficits. In March 2023, the Commission finally announced it would lift the clause by the end of that year (8) and propose opening EDPs in spring 2024 based on 2023 outturn data. On 19 June, the Commission published a report under Article 126(3) of the Treaty on the Functioning of the European Union (TFEU) for twelve Member States. In the report, the Commission concluded that seven of these Member States did not fulfil the deficit criterion and that it intends to propose to open EDPs. Under established practice, reflecting EU law, the proposal for a Council decision on the existence of EDPs and the recommendations on how to correct the excessive deficits have been presented simultaneously (9). However, the Commission suggested splitting these two steps arguing the EDP needs to be reconciled with the adjustment path under the revised preventive arm of the Stability and Growth Pact (SGP) (10). This means the guidance on what countries should do to correct their fiscal imbalance will slip to late autumn, when the national budgetary processes will be in an advanced stage. This is a precedent creating uncertainty on fiscal policy for 2025, and can affect the standing of the corrective arm vis-à-vis the preventive arm going forward.

The EFB considers a sizeable restrictive fiscal impulse to be appropriate in 2025. International institutions, including the Commission, anticipate the euro area economy to operate around its full capacity in 2025, with labour markets expected to remain very tight and inflation slightly above the ECB's target. In addition, grant-financed RRF expenditure is expected to add approximately ½% to the euro area's GDP. Given the favourable macroeconomic outlook and the very high level of fiscal support, a sizeable restrictive fiscal impulse in 2025 is appropriate. In particular, national fiscal policies should address the underlying expenditure drift while protecting investment. Member States with very high debt levels such as Belgium, Greece, Spain, France and Italy, which according to the Commission's latest debt sustainability monitor (DSM) (11) are still classified as being at high risk in the medium-term, should seize the opportunity to make an extra effort to reduce their underlying budget deficits. This would be in line with the risk-based and country-specific approach underpinning the reformed framework.

The transition to the new EU fiscal rules comes with risks for the euro area's fiscal stance. Following the political agreement on the

(6) See section 3 for a more detailed discussion of what the new EU fiscal framework implies for the euro area fiscal stance.

(7) Besides the ongoing EDP for Romania (see EFB 2023).

(8) Commission Communication on fiscal policy guidance for 2024.

(9) Namely Article 126(6) and 126(7) TFEU.

(10) See Commission Spring Package Communication

(11) See Debt Sustainability Monitor 2023 - European Commission (europa.eu)

economic governance review reached by the EU legislators, the Council and the Commission decided to implement the reformed fiscal rules as of 2025. This creates a potential vacuum in implementing EU fiscal surveillance cycle with implications for 2025. Back in spring 2023, the EU Council adopted country-specific recommendations for 2024 setting out speed limits for net primary expenditure growth. Latest available estimates suggest that the fiscal position in several large euro-area countries in 2024 will be significantly worse than previously expected and recommended. Without clarity on how such slippages will be treated in the transition phase – the severe economic downturn clause no longer applies in 2024 – the euro area is likely to enter 2025 with a much higher level of fiscal support than previously forecast and appropriate given the macroeconomic conditions and outlook.

3. The euro-area fiscal stance in the reformed fiscal framework

Debt sustainability is a precondition for fiscal stabilisation. This fundamental insight underpinned the original design of the SGP as well as successive reforms. Sound fiscal policies leave fiscal space that allow national governments to stabilise their economies in the event of country-specific shocks – mostly through the operation of automatic stabilisers. Common shocks to the euro area are meant to be addressed through a centralised monetary policy (12). Therefore, as long as national fiscal policy makers comply with the commonly agreed rules, the need for active or discretionary fiscal stabilisation should only rarely arise.

In practice, the SGP did not work as intended in some Member States. There were three main reasons for this. First, compliance with the commonly agreed fiscal rules varied significantly across countries; some accumulated increasing levels of debt, thereby eroding the room for manoeuvre for active or even automatic stabilisation at sustainable market rates in the event of a major economic downturn. Second, common shocks on the scale observed since the global economic and financial crisis of 2008 had not been anticipated when the SGP was designed. Third, and linked to the second point, a secular decline in nominal interest rates narrowed the conventional policy space of the monetary authorities, who found themselves constrained by the zero lower bound, implying a larger role for fiscal policy.

The global financial crisis pushed the euro-area fiscal stance to the centre of the policy debate. Confronted with a situation where the ECB and some Members States had run out of conventional policy space, euro-area decision-makers started to worry about how to prevent the single currency area from breaking apart. As a result, new crisis management instruments, notably the European Stability Mechanism, were created. In 2011, on its own initiative, the Commission issued for the first time a recommendation for the euro area offering guidance on what it considered an appropriate orientation of fiscal policy for the single currency area as a whole and how individual Member States could contribute to it. The concept of the euro-area fiscal stance was given additional attention in the Five Presidents' Report of 2015 (13) and with the creation of the EFB the same year (14).

The role of the euro-area fiscal stance in the new framework remains an open question among Member States. Although it has become common practice to discuss the euro-area fiscal stance, the concept is controversial.

(12) Considering that common shocks can have a varying impact on individual Member States.

(13) The Five Presidents' Report: Completing Europe's Economic and Monetary Union - European Commission (europa.eu)

(14) The EFB is mandated to provide an annual assessment on the appropriate euro-area fiscal stance for the next year. In particular, the euro-area fiscal stance is now mentioned for the first time in the legal acts of the SGP when describing the tasks of the EFB under the new framework.

After the global economic and financial crisis, two views on the SGP's shortcomings emerged among Member States: one focusing on the causes, in particular non-compliance with the numerical rules (this view was concerned with how to make the rules more effective), and the other concentrating on the consequences, thereby calling for a centralised stabilisation mechanism. The recent agreement on the reformed SGP reflects this divide and the euro-area fiscal stance has not become an explicit objective of the EU's legal economic governance framework. At the same time, the EFB is mandated to make an annual assessment of the appropriateness of the euro-area fiscal stance for the coming year.

The reformed fiscal framework in a nutshell

The reformed fiscal framework has a medium-term orientation tailored to country-specific conditions. The economic governance review concluded in spring 2024 with a reform of the EU's fiscal framework that will be applied for the first time in the 2025 surveillance cycle ([15]). The new system is built around a debt anchor and a single operational indicator in the form of medium-term net expenditure ceilings. The medium-term, country-specific orientation enables high-debt countries to adjust their public finances in a more gradual risk-based way. ([16]) As a counterbalance, quantitative safeguards constrain net expenditure growth to ensure a minimum adjustment of both debt and deficit ratios.

That said, it remains unclear at this stage whether genuine advances (the focus on public debt sustainability, a country-specific, medium-term approach, and a central role for expenditure ceilings) will be allowed to play fully. The political deal produced an array of safeguards to ensure minimum levels of deficit and debt reduction bringing back the year-by-year logic of the old system and negating the initial intent to simplify rules-based governance. Meanwhile, strengthening enforceability in practice was neglected. In the end, actual implementation will tell whether the new framework manages to address the flaws of the old system.

The macroeconomic stabilisation in the reformed fiscal framework

If expenditure ceilings are taken seriously, the new fiscal framework can improve macro-economic stabilisation. One of the key questions raised by the Commission when it relaunched the economic governance review back in October 2021 was how to 'ensure responsible fiscal policies that safeguard long-term sustainability, while allowing for short-term macroeconomic stabilisation' ([17]). The main elements to improve macro-economic stabilisation are: (a) using net primary expenditure as the key and sole operational indicator; (b) a medium-term orientation of national budgetary policies; and (c) an improved design of SGP's escape clauses.

a) Net primary expenditure indicator

The new surveillance system is built around risk-based trajectories of net government expenditure. In the reformed framework the Commission provides a reference trajectory for each Member State in breach of the deficit reference value of 3% of GDP or the debt reference value of 60% of GDP. The reference trajectory sets a ceiling on net expenditure growth to ensure debt is put on a plausibly declining path. The reference trajectory feeds into the national medium-term fiscal-structural plan. The move from a system centred on the structural budget balance of individual years to one centred on a multiannual expenditure path shifts the focus to fiscal indicators that are considered to be under government control.

([15]) European Commission 2024..

([16]) The adjustment period can be extended from 4 to 7 years on the basis of investment and structural reform commitments.

([17]) European Commission 2021

Sticking to an agreed expenditure path allows for automatic stabilisation. The agreed expenditure ceilings under the reformed framework are net of discretionary revenue measures while government revenues will increase or fall over the economic cycle. These revenue fluctuations, combined with a stable expenditure path, have a built-in, automatic stabilisation effect on aggregate demand. This effect was already meant to play out in the old framework but – due to the multiple of operational indicators and implementation choices – this only succeeded in some countries in some years. Moreover, the reformed framework's net expenditure indicator excludes interest expenditures on government debt, cyclical unemployment expenditure and 'one-offs'. Unless additional adjustments are made, these exclusions, including that of debt-servicing costs, weaken the link to the debt anchor.

b) Medium-term perspective of 4 or 7 years

By design, the new framework has a medium-term orientation. The old fiscal framework had a short-term focus as targets were largely set on an annual basis 1 year in advance. As a result, regular revisions of data, forecasts and operational indicators added considerable noise to what was expected of Member States' fiscal policies. Conversely, the new system is centred on the medium term to bring hopefully more stability to both guidance and implementation. Moreover, a control account measuring deviations from the agreed expenditure path offers some leeway before deploying the procedures and instruments of enforcement. ([18])

c) Escape clauses to deal with large shocks

Large economic shocks can be addressed by escape clauses. The medium-term orientation and smoothing feature of the expenditure path described above enable governments to lean against normal economic headwinds and make use of upswings to keep public finances on a sustainable path. Beyond normal cyclical downturns, larger shocks in one country can be addressed by country-specific escape clauses ([19]). If the euro area experiences a severe economic downturn, the area-wide escape clause can be activated as was the case during the Covid-19 pandemic. The clause allows the Commission, endorsed by the Council, to grant temporarily – for 1 year – flexibility in terms of the required net expenditure path, thereby leaving some scope for further discretionary stabilisation – provided this does not endanger fiscal sustainability. An extension of the clause involves the EFB issuing an opinion.

The euro-area fiscal stance concept in the new framework

Following the agreed expenditure path puts fiscal stabilisation on 'autopilot'. In the absence of major shocks that may warrant recourse to an escape clause, countries will benefit from the strengthened automatic stabilisation properties of the reformed framework by sticking to the agreed medium-term expenditure path across the business cycle. Experience clearly shows that fiscal fine-tuning rarely works. Therefore, compared to the past, dedicated discussions are more likely to confirm the appropriateness of the fiscal stance under normal cyclical conditions.

Effective implementation of the reformed rules is needed to improve macroeconomic policy making in the euro area. The reformed EU fiscal framework aims to strengthen fiscal sustainability through gradual and tailor-made adjustments complemented by reforms and investment. This would bolster the division of labour between fiscal and monetary policy set out in the Treaty and enable monetary policy to focus on its inflation objective, including in the event of larger economic shocks. The reformed

([18]) The control account tracks the cumulative deviations from the expenditure ceiling during each fiscal-structural plan. The threshold is set at 0.6% of GDP on a cumulative basis.

([19]) The clause can be used in the event of exceptional circumstances that have a sizeable rules' improved automatic stabilisation may prove sufficient in normal times. However, mixed experiences with the previous framework calls for some caution. The new system's clear advantages for macroeconomic stabilisation will only come to fruition if the rules are implemented and followed as intended. This has been a major issue affecting the previous system where implementation for some countries or some aspects fell clearly short of aspirations, especially when it came to building fiscal buffers in good times. It will be an uphill fight to overcome the diminishing attention to fiscal sustainability, accentuated by four years largely without rules.

Different types of shocks require different policy responses. The built-in stabilising properties of the reformed framework should be effective in the event of demand shocks. However, if there is a major and persistent supply shock, a re-assessment of sustainable levels and growth rates of primary expenditure is clearly warranted. In the future, unfavourable supply developments – arising, in particular from global warming, ageing and de-globalisation – and their related shocks will put increasing pressure on the framework. In such circumstances, dedicated discussions at the euro-area level will continue to be relevant to ensure both an appropriate orientation of fiscal policy for the single currency area as a whole and the sustainability of national public finances.

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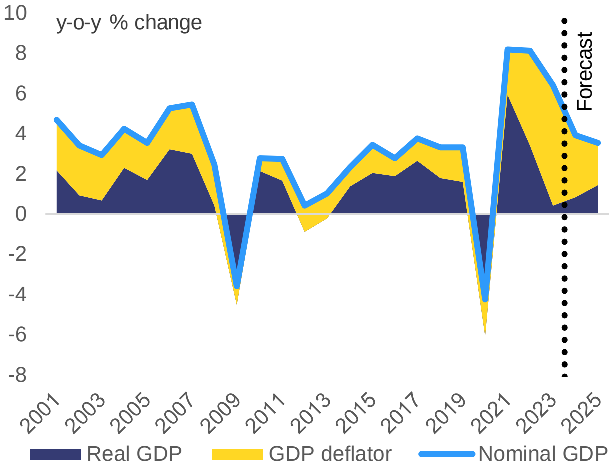
fiscal impact and are beyond government control.

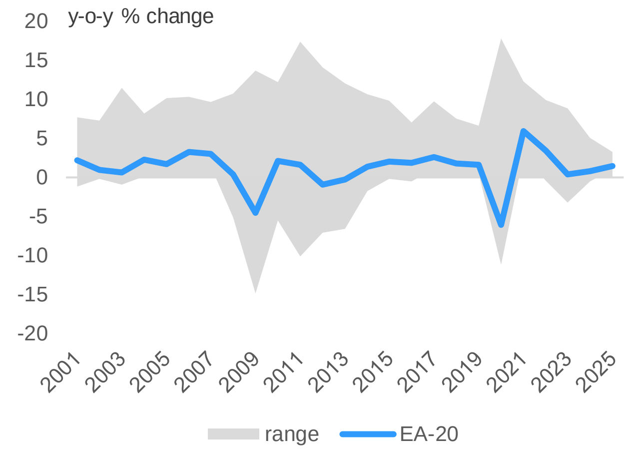
THE MACROECONOMIC OUTLOOK

Graph 1.1: Nominal and real GDP growth, euro area



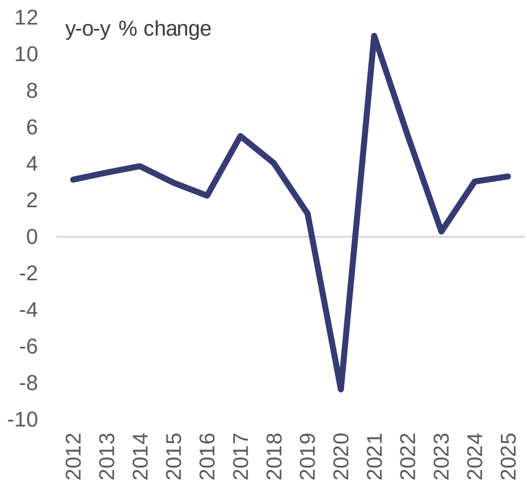
Source: European Commission.

Graph 1.2: Differences in GDP growth in the euro area



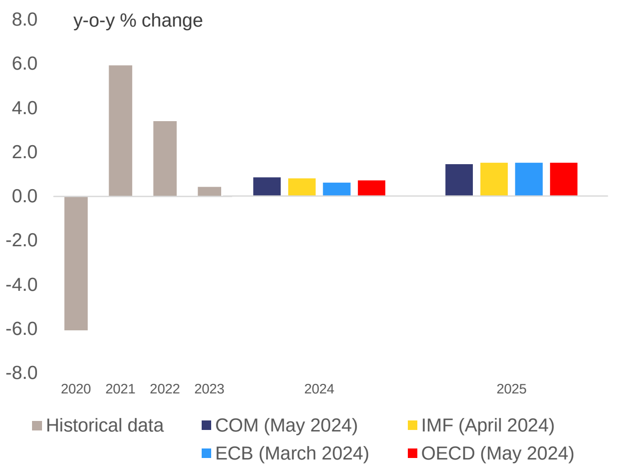
Source: European Commission.

Graph 1.3: Global trade volume



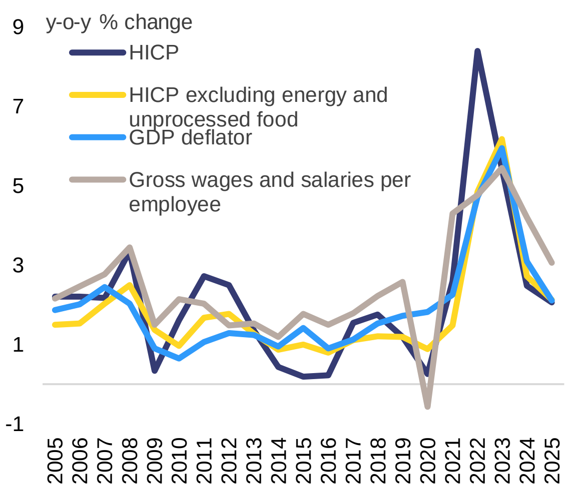
Source: IMF World Economic Outlook, April 2024.

Graph 1.4: Euro area real GDP



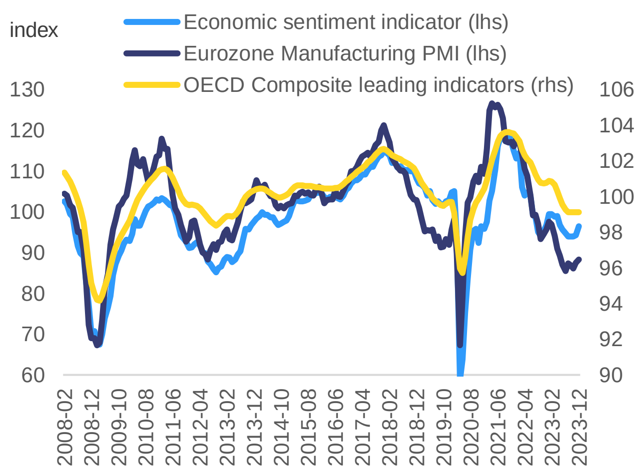
Source: European Commission, OECD, IMF and ECB. Forecasts for 2024 and 2025.

Graph 1.5: Inflation and wages, euro area



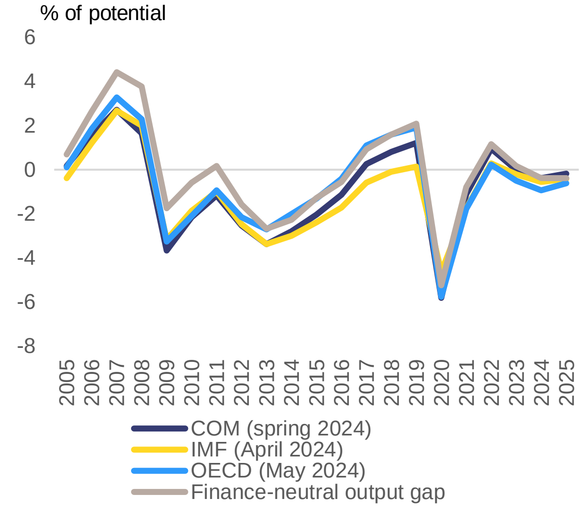
Source: European Commission.

Graph 1.6: Economic survey indicators, euro area



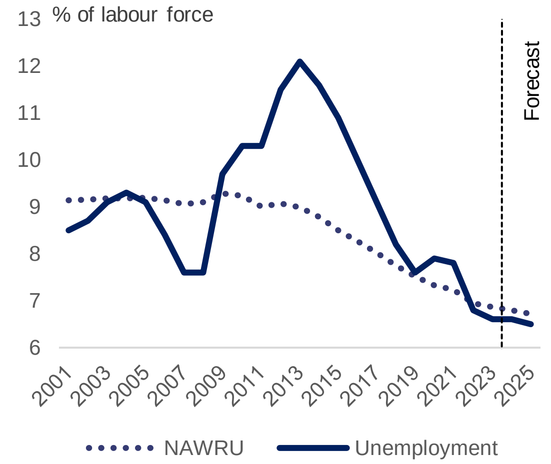
Source: European Commission, OECD, IHS Markit.
Notes: Manufacturing Purchasing Managers' Index (PMI) scaled by two for visualisation.

Graph 1.7: Output gap, euro area



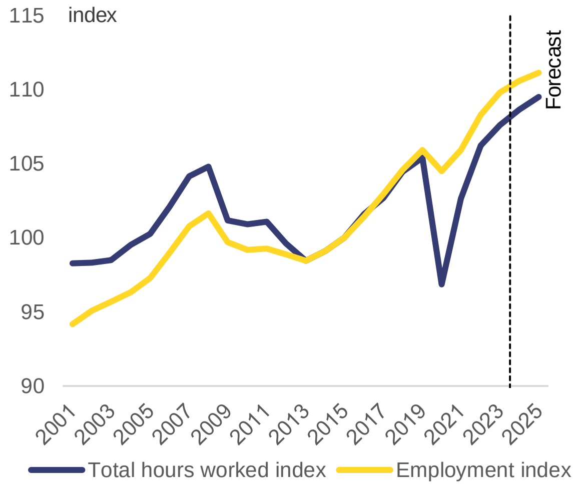
Source: European Commission, OECD, IMF.
Notes: (1) OECD data only includes OECD members, thus 17 euro-area Member States (excl. Croatia Malta and Cyprus); (2) publication dates OECD (June 2023), COM (May 2024), IMF (April 2024); (4) The finance-neutral output gap is derived from an extended HP filter that takes into account short-term real interest rates, credit growth and house price inflation.

Graph 1.8: Unemployment rate, euro area



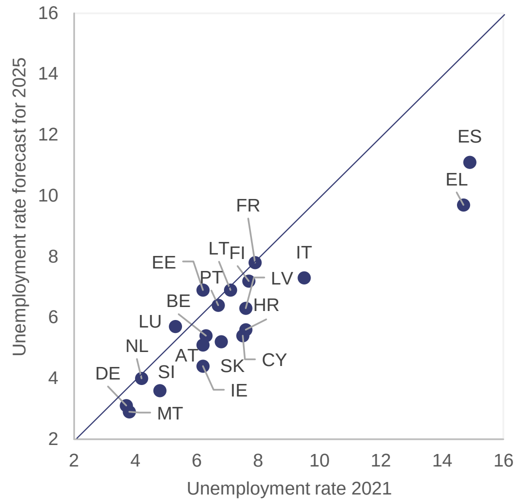
Source: European Commission.
Notes: NAWRU refers to the non-accelerating wage rate of unemployment.

Graph 1.9: Employment and total hours worked



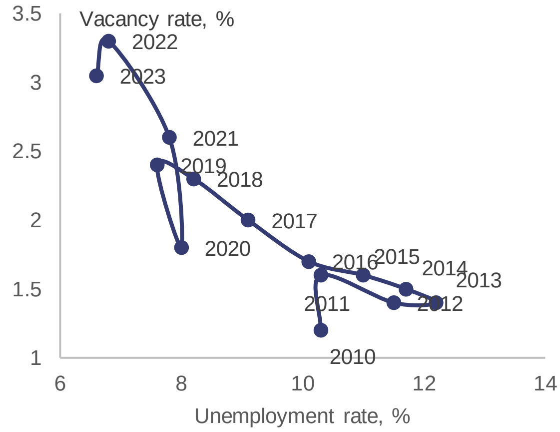
Source: European Commission.

Graph 1.10: Unemployment across Member States



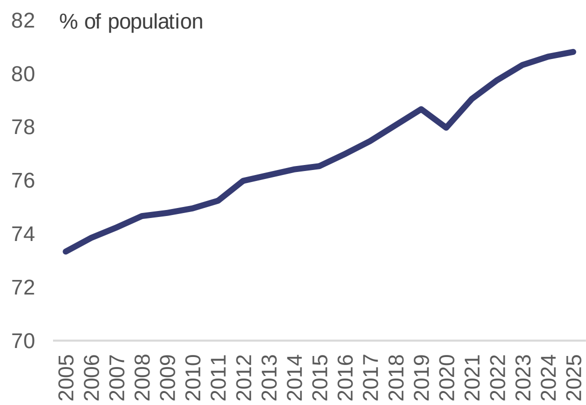
Source: European Commission.

Graph 1.11: Euro area Beveridge curve



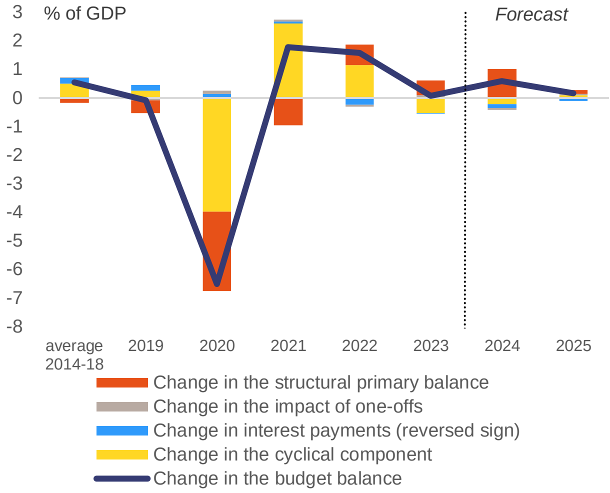
Source: European Commission.
Notes: The Beveridge curve depicts the relationship between the vacancy rate and unemployment rate.

Graph 1.12: Euro area labour force participation rate



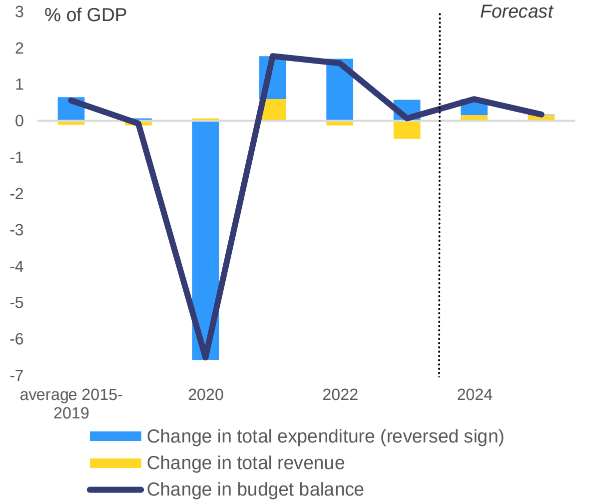
Source: European Commission.
Notes: Age group 15 to 64 years.

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



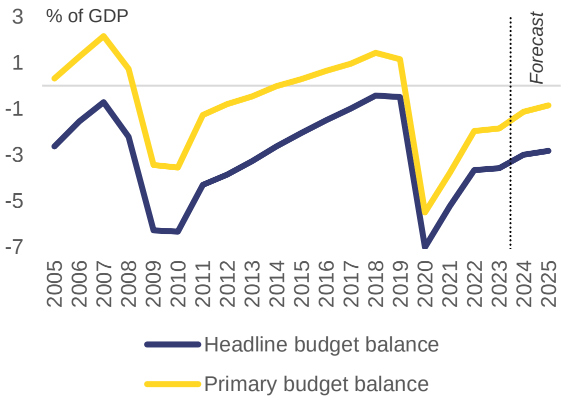
Source: European Commission.
Note: A decrease in interest payments is shown as an improvement in the headline balance.

Graph 2.2: Government revenue and expenditure; euro area aggregate



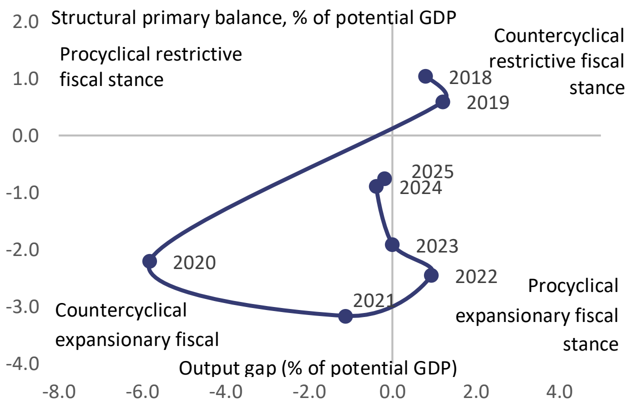
Source: European Commission.

Graph 2.3: Headline budget balance, euro area aggregate



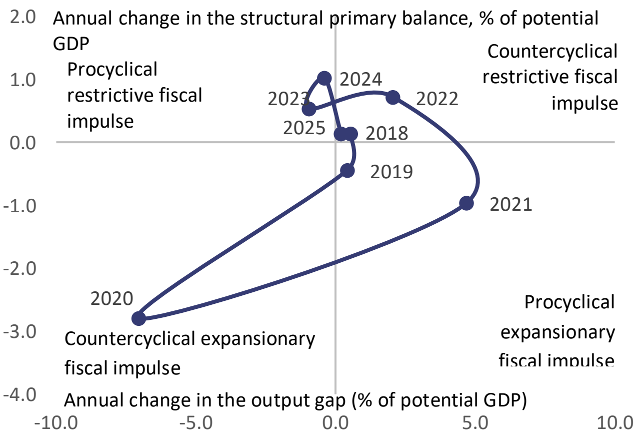
Source: European Commission.
Notes: Primary budget balance excludes interest expenditure.

Graph 2.4: Fiscal stance, the structural primary balance; euro area aggregate



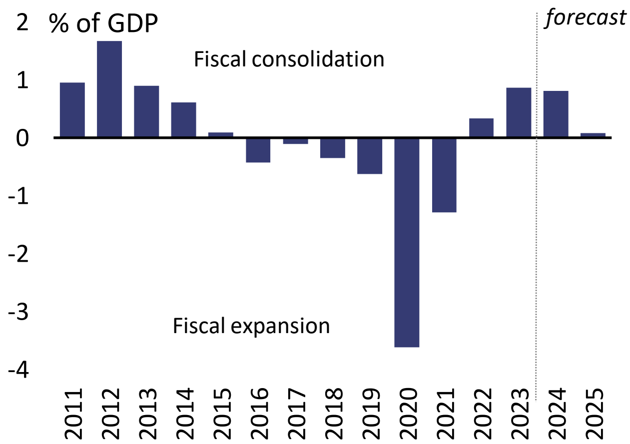
Source: European Commission.

Graph 2.5: Fiscal impulse, change of the structural primary balance, euro area aggregate



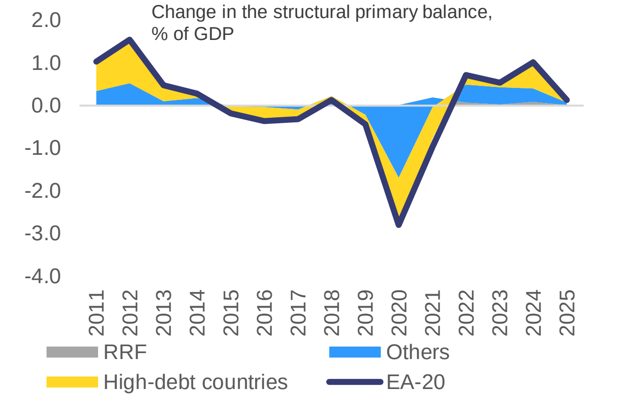
Source: European Commission.

Graph 2.6: Fiscal impulse as measured by the expenditure benchmark; euro area aggregate



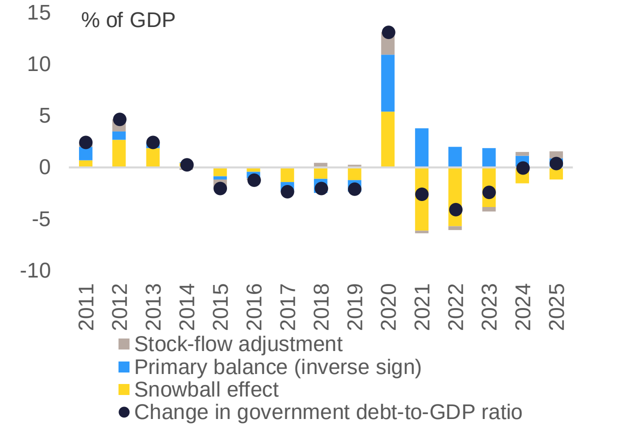
Source: European Commission, own calculations.
Notes: The graph shows the difference between net expenditure growth and medium-term potential growth (see Glossary). If net expenditure growth exceeds medium-term potential growth, the fiscal impulse is considered expansionary.

Graph 2.7: Contributions of countries to the aggregate fiscal impulse



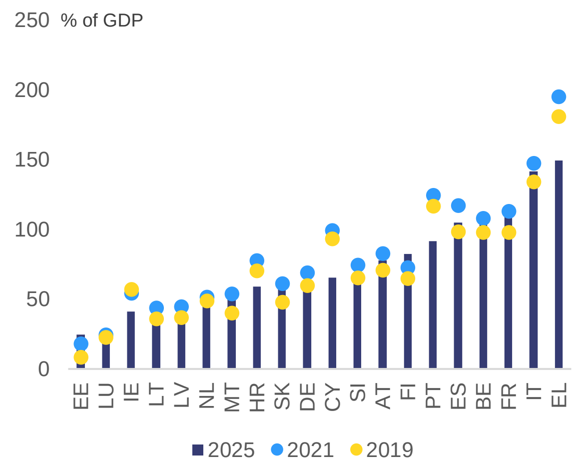
Source: European Commission.
Notes: The group of high-debt countries includes the euro area countries with a debt-to-GDP ratio above 90% in 2022: Belgium, Greece, Spain, France, Italy, and Portugal. Their share in the euro area GDP is 52% in 2023. Others: the remaining countries of the euro area.

Graph 2.8: Drivers of government debt-to-GDP ratio; euro area aggregate



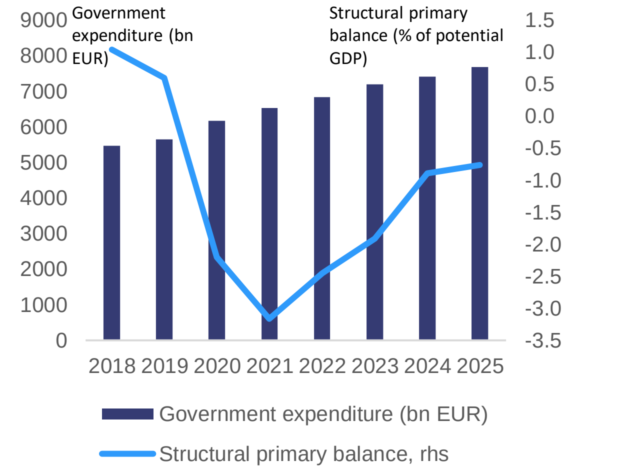
Source: European Commission.
Notes: The snowball effect combines the impact of interest expenditure and of nominal GDP growth on the debt-to-GDP ratio: if GDP does not grow sufficiently fast to offset the cost of servicing debt, the debt ratio increases.

Graph 2.9: Government debt levels



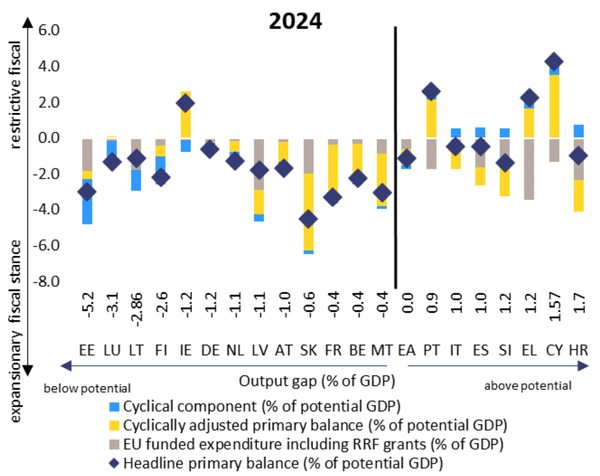
Source: European Commission.

Graph 2.10: Euro area government expenditure and structural primary budget balance



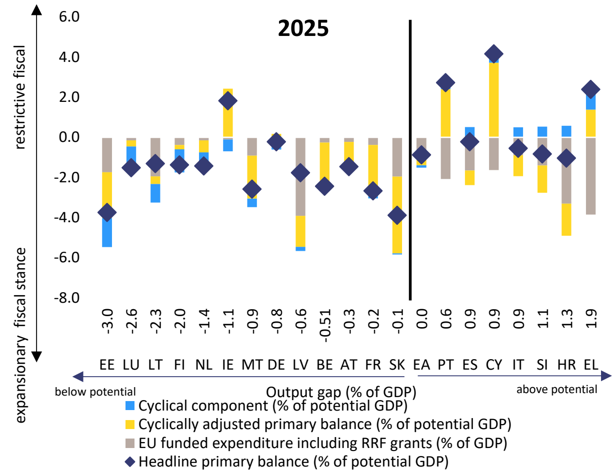
Source: European Commission.

Graph 2.11: Fiscal stance and cyclical conditions across euro area Member States in 2024



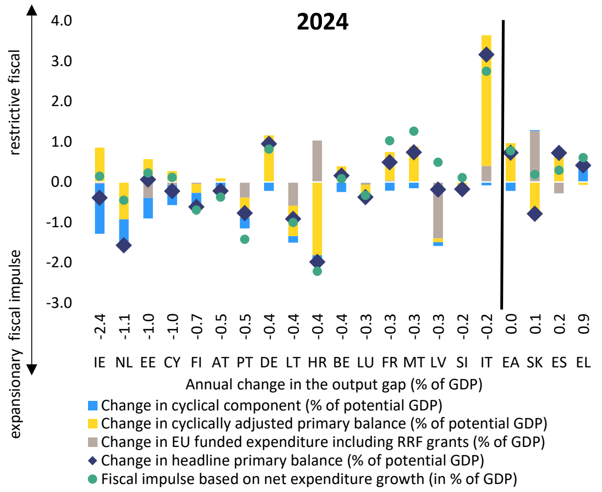
Source: European Commission.

Graph 2.12: Fiscal stance and cyclical conditions across euro area Member States in 2025



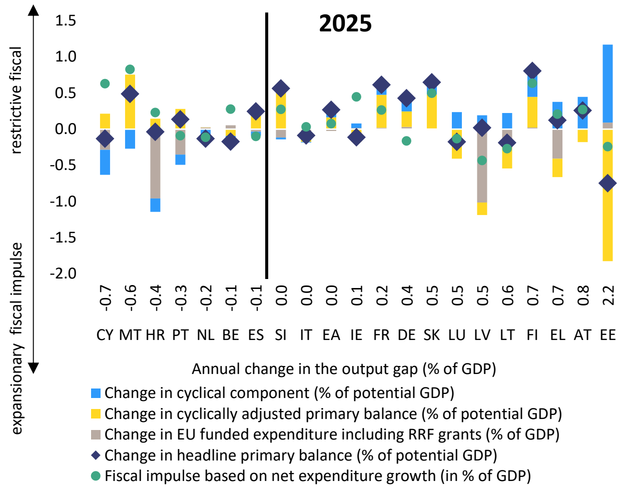
Source: European Commission.

Graph 2.13: Fiscal impulse and cyclical conditions across euro area Member States in 2024



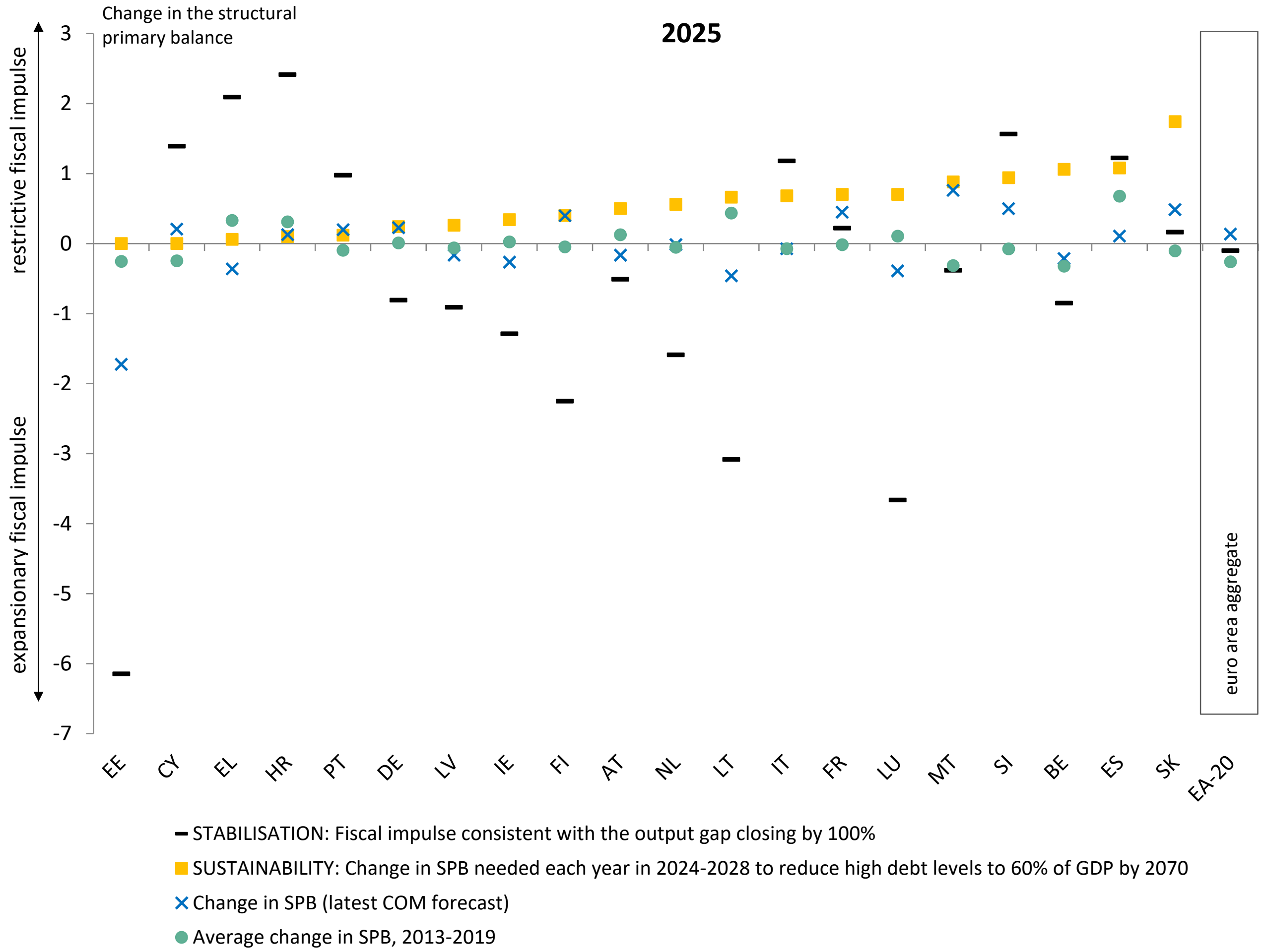
Source: European Commission.

Graph 2.14: Fiscal impulse and cyclical conditions across euro area Member States in 2025



Source: European Commission.

Graph 2.15: 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 2024 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 European Commission's S1 indicator has been divided by 5 to stretch the required fiscal adjustment over 5 years. Estimates include the costs of ageing (see 2023 Debt Sustainability Monitor)
(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 2023 and the Commission's spring forecast 2024.

Key indicators for the euro area

Output		LTA (1)	2020	2021	2022	2023	23Q1	23Q2	23Q3	23Q4	24Q1
Economic sentiment	Indicator	99.4	87.9	111.2	102.1	96.4	99.2	97.2	94.2	94.8	96.0
Gross domestic product	% ch. on prev. period						-3.1	1.3	-0.1	2.0	-3.0
	% ch. on prev. year	1.5	-6.1	5.9	3.4	0.5	1.6	0.4	-0.1	0.0	0.1
Labour productivity	% ch. on prev. period						-2.8	0.1	-0.7	2.3	-2.5
	% ch. on prev. year	0.6	-4.7	4.4	1.1	-1.0	-0.1	-1.1	-1.5	-1.2	-0.9
Private consumption		**LTA (1)**	**2020**	**2021**	**2022**	**2023**	**23Q1**	**23Q2**	**23Q3**	**23Q4**	**24Q1**
Consumer confidence	Balance (2)	-11.2	-14.2	-7.5	-21.9	-17.4	-19.6	-17.0	-16.3	-16.6	-15.5
Retail confidence	Balance (2)	-8.1	-12.6	-1.5	-3.5	-4.0	-2.4	-2.3	-3.8	-7.3	-7.5
Private consumption	% ch. on prev. period						0.0	0.1	0.4	0.2	0.2
	% ch. on prev. year	1.2	-7.7	4.4	4.2	0.5	1.3	0.6	-0.3	0.7	0.8
Retail sales	% ch. on prev. period						-12.7	5.6	0.0	8.2	
	% ch. on prev. year	1.0	0.3	4.8	0.2	-1.6	-2.9	-1.8	-1.4	-0.3	
Investment		**LTA (1)**	**2020**	**2021**	**2022**	**2023**	**23Q1**	**23Q2**	**23Q3**	**23Q4**	**24Q1**
Capacity utilisation	Level (%)	80.8	74.5	81.5	82.2	80.6	81.5	81.3	80.1	79.6	79.2
Production expectations (manufacturing)	Balance (2)	7.5	-1.3	19.9	10.0	4.3	10.4	3.9	1.3	1.8	0.6
Gross fixed capital formation (3)	% ch. on prev. period						0.5	0.2	0.1	0.8	-1.5
	% ch. on prev. year	1.7	-5.9	3.5	2.5	1.2	1.9	1.7	0.7	1.6	-0.5
- equipment investment	% ch. on prev. period						2.1	0.4	0.6	-2.7	0.3
	% ch. on prev. year	2.7	-11.6	8.1	4.5	3.2	5.6	5.3	2.7	0.4	-1.4
- construction investment	% ch. on prev. period						1.0	-0.4	-0.4	-0.6	0.7
	% ch. on prev. year	0.5	-3.4	5.7	1.3	-0.7	-0.9	-0.5	0.0	-0.4	-0.6
Change in stocks	Contrib. to GDP (pp)	0.6	0.4	1.2	2.0	0.6	0.8	0.7	0.2	0.5	-0.1
Labour market		**LTA (1)**	**2020**	**2021**	**2022**	**2023**	**23Q1**	**23Q2**	**23Q3**	**23Q4**	**24Q1**
Employment expectations (manufacturing)	Balance (2)	-5.6	-12.4	8.4	10.5	1.9	7.1	2.9	0.1	-2.4	-2.7
Employment expectations (services)	Balance (2)	6.2	-5.6	9.0	12.0	8.7	12.2	8.8	6.0	7.7	7.1
Employment	% ch. on prev. period						0.6	0.2	0.2	0.3	0.3
	% ch. on prev. year	0.9	-1.4	1.5	2.3	1.5	1.7	1.5	1.4	1.2	1.0
Employment (000)	ch. on prev. period		-9300	9219	14815	9575	938	253	420	433	547
Compensation of employees	% ch. on prev. period						1.4	0.8	1.4	1.2	1.6
(per head, nominal)	% ch. on prev. year	2.4	-0.4	4.4	4.7	5.2	5.4	5.3	5.4	4.9	5.1
Unemployment rate	% of lab. force		8.0	7.8	6.8	6.6	6.6	6.5	6.6	6.5	
Unemployment (000)	ch. on prev. period		1690	-593	-5746	-880	-50	-124	95	-61	
International transactions		**LTA (1)**	**2020**	**2021**	**2022**	**2023**	**23Q1**	**23Q2**	**23Q3**	**23Q4**	**24Q1**
World trade	% ch. on prev. period						-0.9	-0.2	-0.3	0.4	0.3
	% ch. on prev. year		-5.4	10.0	2.7	-1.9	-1.3	-1.9	-3.3	-1.1	0.2
Export order books	Balance (2)	-17.1	-32.7	-1.5	-0.1	-14.2	-6.2	-9.6	-18.5	-22.4	-20.9
Trade balance (merchandise)	Billion EUR		220	99	-345	61	-8.4	2.9	26.6	40.4	60.0
Exports of goods and services	% ch. on prev. period						-0.4	-1.0	-1.3	0.2	1.4
	% ch. on prev. year	4.5	-9.1	11.5	7.2	-0.8	3.1	0.0	-2.7	-2.5	-0.8
Imports of goods and services (3)	% ch. on prev. period						-1.2	-0.2	-1.6	0.6	-0.3
	% ch. on prev. year	4.3	-8.5	9.2	7.9	-1.4	1.9	-0.1	-4.0	-2.4	-1.5
Prices		**LTA (1)**	**2020**	**2021**	**2022**	**2023**	**23Q1**	**23Q2**	**23Q3**	**23Q4**	**24Q1**
Headline inflation (HICP)	% ch. on prev. year		0.3	2.6	8.4	5.5	8.0	6.2	4.9	2.7	2.6
Core inflation	% ch. on prev. year		0.9	1.5	4.8	6.2	7.4	7.0	6.1	4.4	3.3
Monetary and financial indicators		**LTA (1)**	**2020**	**2021**	**2022**	**2023**	**23Q1**	**23Q2**	**23Q3**	**23Q4**	**24Q1**
Nominal interest rates (3-month)	Level		-0.4	-0.5	0.3	3.4	2.6	3.4	3.8	4.0	3.9
Nominal interest rates (10-year)	Level		-0.51	-0.37	1.14	2.43	2.31	2.36	2.56	2.51	2.29
ECB repo rate	Level		0.00	0.00	2.50	4.50	3.50	4.00	4.50	4.50	4.50
Bilateral exchange rate USD/EUR	Level		1.14	1.18	1.05	1.08	1.07	1.09	1.09	1.08	1.09
	% ch. on prev. period						5.14	1.51	-0.08	-1.15	0.92
	% ch. on prev. year		1.94	3.70	-10.95	2.63	-4.41	2.23	8.08	5.42	1.19
Nominal effective exchange rate	% ch. on prev. period						2.1	1.3	1.9	0.0	0.6
	% ch. on prev. year		2.9	2.4	-0.2	4.8	2.3	4.1	7.3	5.4	3.8

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

Notes: Data in the table have been taken from different sources available until 13 June 2024 and at different moments in time. (1) LTA = Long-term average (since 1990 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 percentage 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.

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').

Reference trajectory: estimation based on a debt-sustainability analysis that shows how much fiscal effort over the adjustment period (of 4 or 7 years) is required from a Member State to ensure that government debt is put on a plausibly declining trajectory.

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.