

European Fiscal Board

# **Assessment of the fiscal stance appropriate for the euro area in 2022**

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# Key messages of report



Euro area expected to surpass **pre-pandemic level of annual real GDP in 2022**, but important differences among countries



**Fiscal stance for 2022** implied by current policies (incl. RRP) **appears appropriate**: emergency measures are withdrawn as economy rebounds, but fiscal stance remains supportive



Fiscal support has to become **more targeted**, leaving more scope for **growth-enhancing expenditure**



**Review of EU fiscal framework** while the severe economic downturn clause is still active, **would be an essential element in smoothing a rebalancing of fiscal and monetary policies**

# Purpose of the EFB report

**The report of EFB is embedded in the European semester:** It gives guidance before Member States prepare budgets for the coming year.



# Context of recommendation for euro area fiscal stance 2022

**Assessment of euro area fiscal stance of particular importance** in light of economic impact of Covid pandemic and activation of severe economic downturn clause.

At the same time, **assessment of the fiscal stance particularly challenging at current juncture**

**High level of uncertainty** surrounding economic and fiscal forecasts (vaccination, virus mutations, risk of insolvencies, pent-up demand)

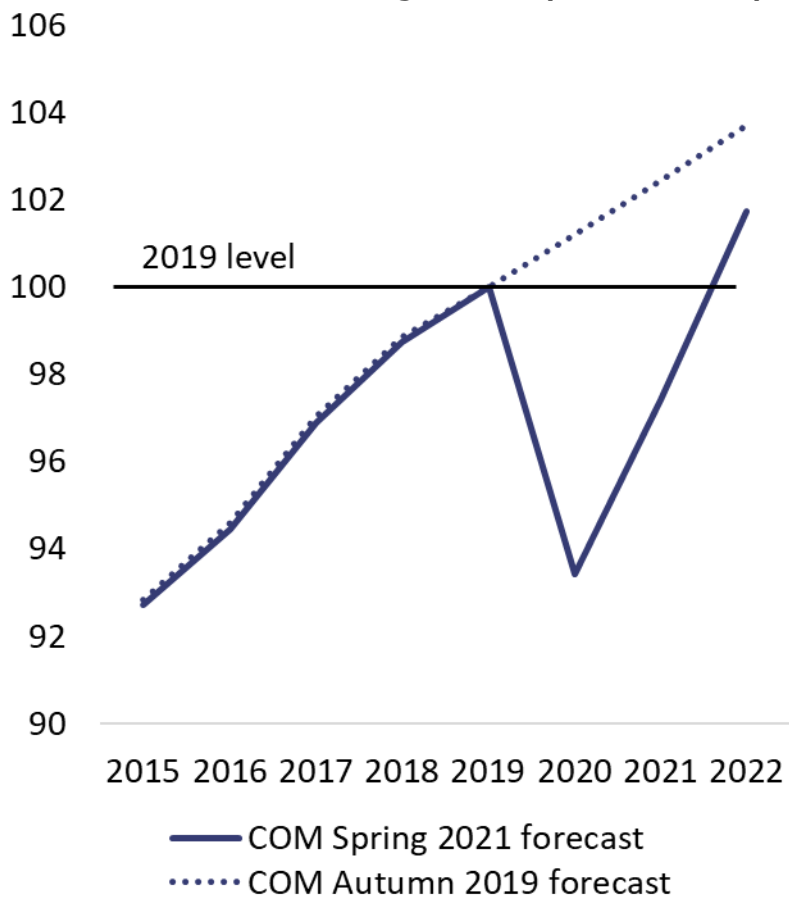
**Differentiating emergency measures from other support measures** not obvious

**Conventional gauges likely to underestimate support** (e.g. government guarantees; EU grants through RRF)

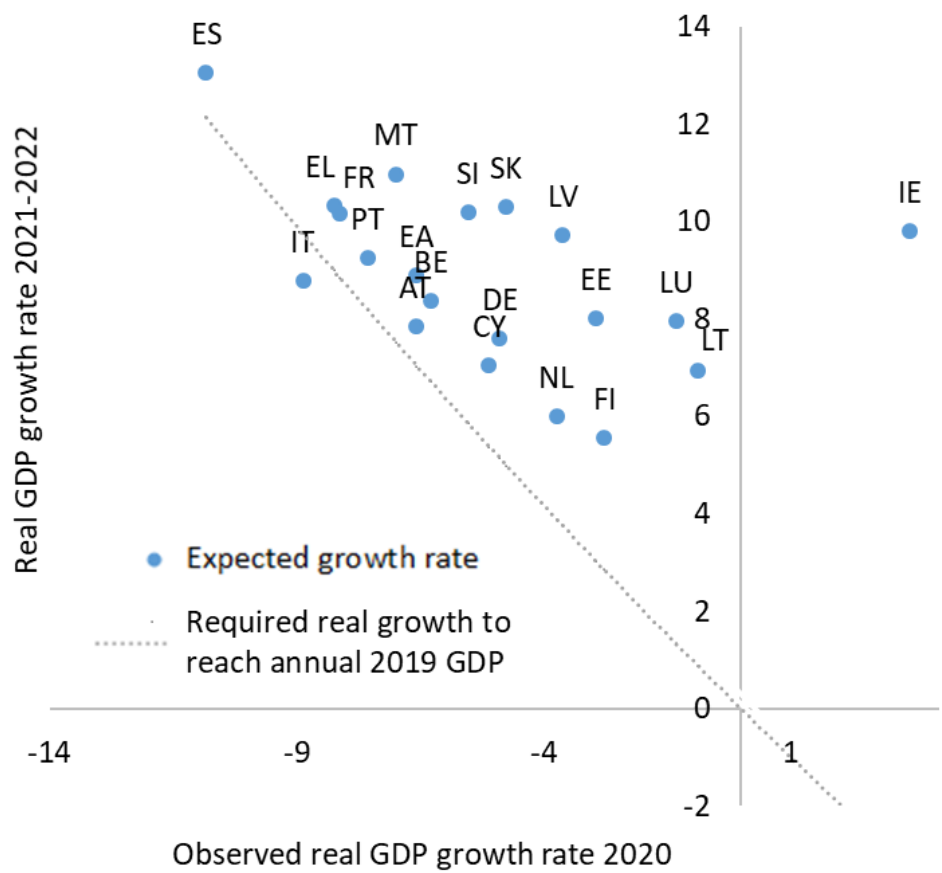
# Current economic context and outlook

- Euro area expected to **return to pre-pandemic output by 2022**
- **But: Uneven recovery** across Member States and sectors

The impact of the pandemic on euro area real GDP growth (2019=100)



Depth of recession and expected recovery by country



Source: European Commission

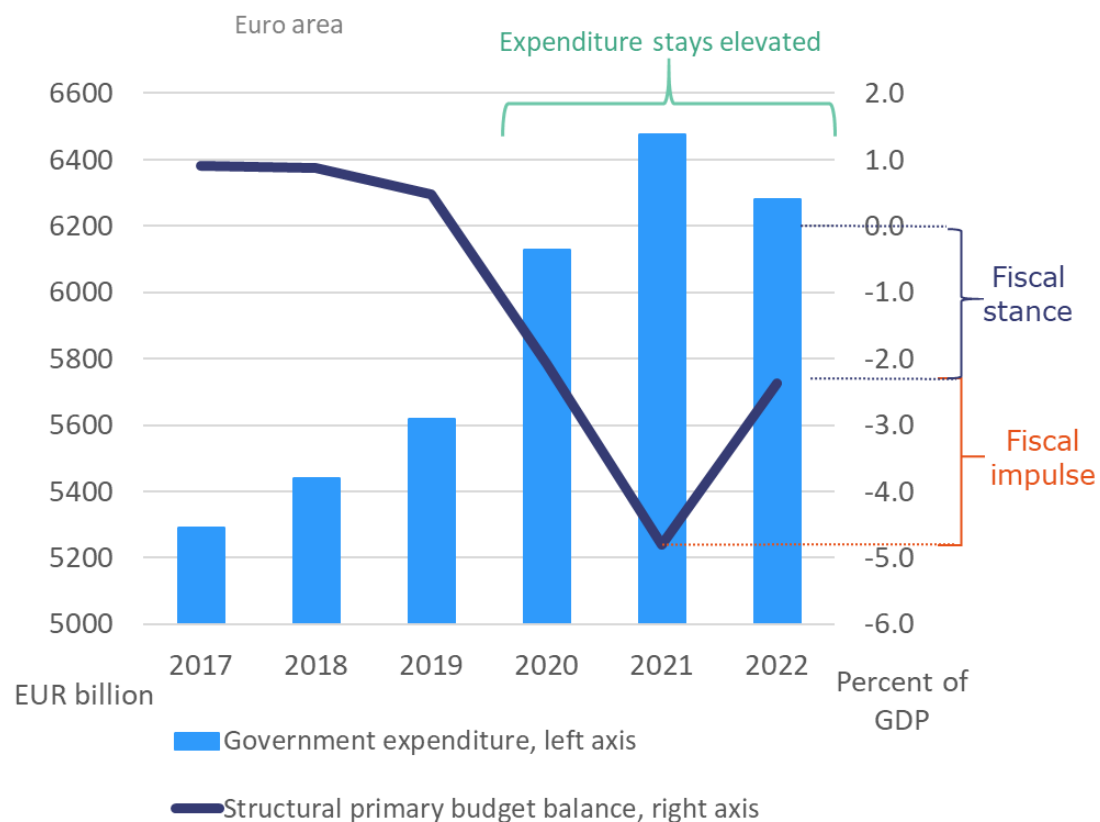
Source: European Commission

# Refined language needed

- **Fiscal stance**: Structural primary budget balance in percent of (potential) output → level of fiscal support
- **Fiscal impulse**: Change in the structural primary budget balance in percent of (potential) output → change in fiscal support

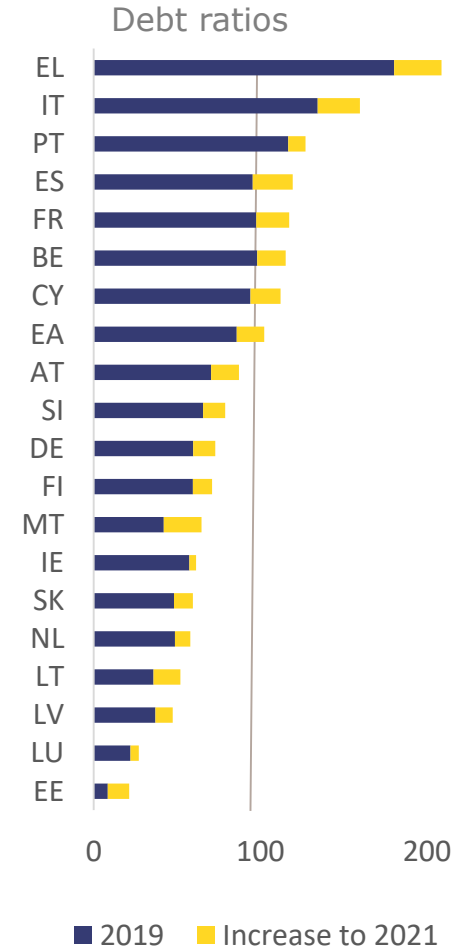
This distinction is **particularly important now**:

- After large budget deficits to contain the crisis, a **contractionary fiscal impulse** alongside rebound is normal.
- **Fiscal stance still supportive** as government expenditures and budget deficit remain well above pre-crisis level also thanks to RRP.



# Sustainability of government debt

- **Euro area debt ratio at ~100% of GDP** (2021), up from 86% (2019); in some countries > 100%.
- Latest Debt Sustainability Monitor points to ***persistent risks over different time horizons.***
- During crisis, **monetary and fiscal policy** have become **mutually reinforcing** (strategic complements): low interest rates create fiscal space and the use of that space makes monetary policy more effective.
- **Likely only a temporary alignment;** if inflation rises durably, borrowing costs will – at a minimum – follow in step.



# Recommendation of the EFB for 2022

- **Euro area fiscal stance in 2022** implied by current policies **appears appropriate.**
- Unless outlook changes significantly, **no need for new impulse in budget plans for 2022.**
- For high debt countries **the RRF offers the opportunity to support the recovery with additional investment and reforms** without affecting the sustainability of public finances in the medium term.
- **Fiscal support has to become more targeted** as most of the economy recovers, leaving more scope for more growth enhancing government expenditure.
- Clarity about **revised EU fiscal rules will allow smooth rebalancing of fiscal and monetary policies.**



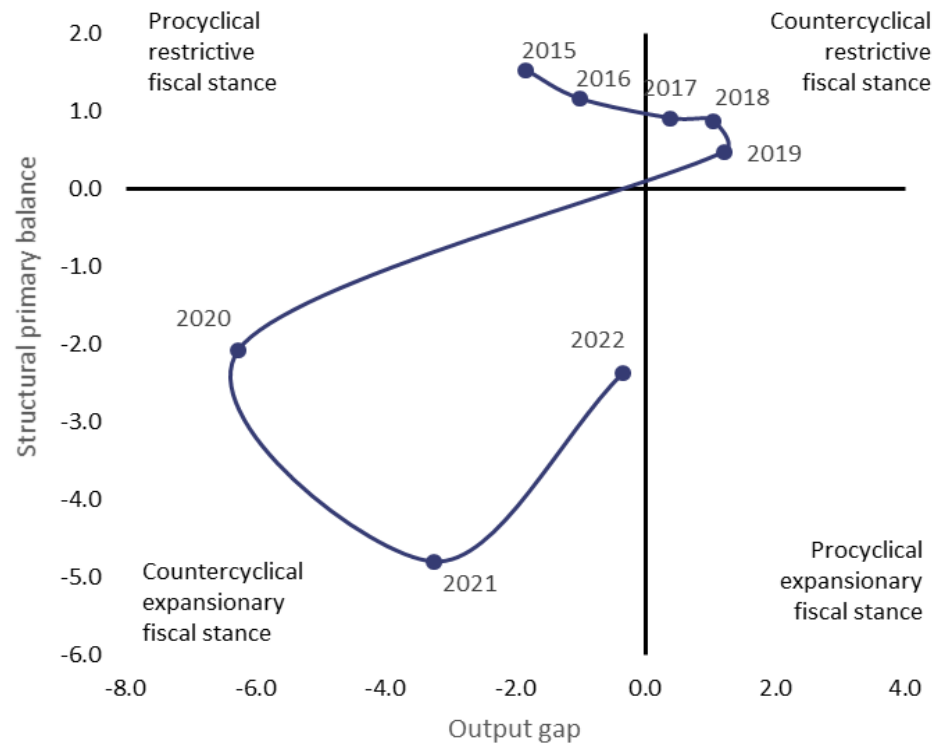
**Thank you for your time!**

**Complementary slides**

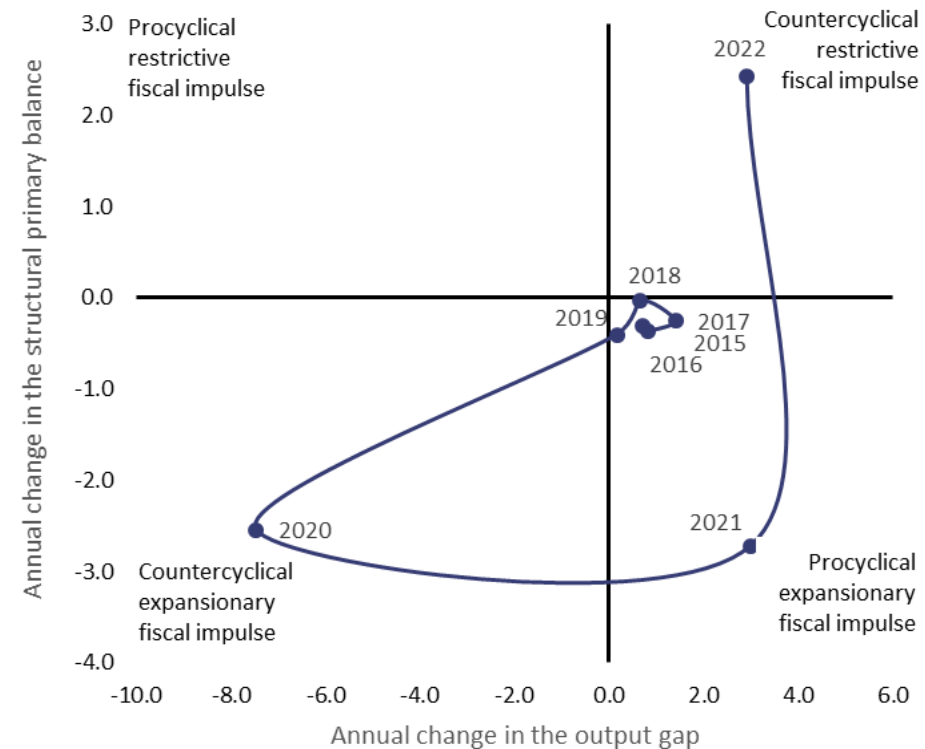
# The euro area fiscal stance and fiscal impulse in 2022

Countercyclical **restrictive fiscal impulse** while still maintaining an overall **supportive fiscal stance** in the euro area

Euro area fiscal stance



Euro area fiscal impulse



# Sustainability concerns and speed of debt reduction

In high debt countries reducing the debt-to-GDP ratio by 10-20 percent by 2036 requires an adjustment in excess of what was observed in the pre-pandemic period.

