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The 2021 Stability & Convergence Programmes

An Overview, with an Assessment of the Euro Area Fiscal Stance

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EXECUTIVE SUMMARY

The 2021 Stability and Convergence Programmes attest to the unprecedented fiscal response to the COVID-19 pandemic in the EU. Facilitated by the swift activation of the general escape clause of the Stability and Growth Pact, the introduction of new EU instruments, and favourable financing conditions, Member States responded with a powerful mix of discretionary fiscal support, the full operation of automatic stabilisers and ample liquidity support. As a result, fiscal policy mitigated a fall in economic activity in 2020, though at the cost of large increases in government deficit and debt ratios. The EU headline deficit increased to about 7% of GDP in 2020 from 0.5% in 2019, while the aggregate debt ratio jumped to 92% of GDP in 2020 from 79% a year earlier.

Fiscal policy at large – including automatic stabilisers – will support a strong and sustainable recovery in 2021 and 2022. As highlighted by the Commission's Communication of 2 June 2021, the job of supporting European economies is not yet done.([1]) Complemented by a highly accommodative monetary policy stance, fiscal policy is expected to remain supportive in 2021 and 2022, thus assisting European businesses, workers and citizens as they get back on their feet. However, the nature of the fiscal support can be expected to change. As the health situation improves, Member States can scale back their emergency aid and focus on supporting economic recovery. Public investment will play an important role during the recovery phase.

Underlying fiscal positions are expected to vary across Member States. As in the past, changes in fiscal positions are analysed through the lenses of the expenditure benchmark, with specific adjustments to address the current challenges. In most Member States, the growth of nationally-financed current expenditure (net of new revenue measures) in 2021 and 2022 is projected to exceed the rate of medium-term potential growth, pointing to a fiscal relaxation and a positive contribution to the overall fiscal stance. A fiscal relaxation of more than 0.5% of GDP in both years is expected in a couple of Member States. By contrast, about a quarter of Member States expect some tightening in line with improving economic situation. To maximise support to the recovery without creating a permanent burden on public finances, the growth of current expenditure (net of new revenue measures) should be kept under control, and be limited in Member States with high debt.

The fiscal stance for the euro area as a whole is projected to remain supportive in 2021 and 2022. Including the fiscal impulse provided at the EU level through the Recovery and Resilience Facility (RRF) and setting aside the phasing out of temporary emergency measures, fiscal policies will provide additional support to aggregate demand in the euro area of around 1¾% of GDP in 2021 and slightly more than ¼% of GDP in 2022. In 2022, this is partly due to increases in nationally-financed current expenditure, which are expected to continue to exceed the rate of medium-term potential growth. Monetary policy is expected to work hand-in-hand with fiscal policy as the recovery gains traction.

The fiscal stance, stemming from national budgets and the EU budget, is expected to remain supportive in almost all Member States in 2021 and 2022 on average. The RRF will provide large-scale financial support to Member States of up to €312.5 billion in grants and €360 billion in loans in the period to 2026. RRF grants will fund high-quality investment projects and enable productivity-enhancing reforms, without giving rise to higher national deficit and debt ratios. These grants and other sources of EU financing will boost public investment in Member States by an average of about 0.5% of GDP per year in 2021 and 2022, thus helping Member States to maintain supportive fiscal stances. Differences between Member States will depend on the allocation of RRF grants relative to GDP and the degree of absorption of those grants.

The pandemic has heightened challenges to debt sustainability. The Commission's latest debt sustainability analysis finds that seven Member States face high fiscal sustainability risks in the medium term, while nine others face medium risks. These results are mostly driven by higher debt ratios than

([1]) Communication from the Commission on Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, Brussels, 2.6.2021, COM(2021)500 final.

before the crisis (due to the severe recession and the needed fiscal response), most of which are projected to fall only gradually. However, the government debt projections and, in turn, the debt sustainability assessment have improved compared to the results published in the 2020 Debt Sustainability Monitor. In the majority of Member States, and especially in countries with high sustainability risks in the medium term, fully implementing the plans presented in the 2021 Stability and Convergence Programmes would alleviate sustainability risks. Generally, the debt dynamics are expected to benefit from the assumed progressive correction of the primary balance and from negative interest - growth differentials. In particular, the prevailing favourable financial environment (as reflected by financial market expectations) and the economic recovery should favour government debt deleveraging over the medium term. Moreover, the implementation of reforms and investments under the RRF is expected to support potential growth, mitigating debt sustainability risks.

INTRODUCTION

This overview note of the 2021 Stability and Convergence Programmes (SCPs) provides an aggregate analysis of medium-term fiscal plans in the European Union and an assessment of the euro area fiscal stance.

The SCPs are a cornerstone of the EU's multilateral fiscal policy coordination.([2]) Each spring, Member States share their economic and budgetary plans for the next three years with their peers and the Commission. Euro area Member States do this in documents known as Stability Programmes, while non-euro area countries submit Convergence Programmes, in line with guidelines set out in the Code of Conduct of the Stability and Growth Pact.([3]) The Commission assesses the individual programmes and evaluates the aggregate trends. This note presents the aggregate assessment.

As last year, this year's note differs from its past editions in order to reflect the extraordinary circumstances of the COVID-19 crisis. The assessment accentuates the ongoing fiscal policy response to the pandemic, the continued activation of the general escape clause of the Pact, and the budgetary support provided by the Resilience and Recovery Facility (RRF). In addition to the information provided in the SCPs, the note also reflects on national Resilience and Recovery Plans (RRPs), which describe Member States' reform and public investment strategies to be supported by the RRF.

The note consists of three sections and several analytical boxes. Section 1 examines the fiscal policy response to the COVID-19 outbreak in 2020. Section 2 presents the budgetary plans set out by Member States for 2021 and 2022 and examines fiscal support provided by the RRF. Section 3 focuses on the euro area as a whole and analyses and assesses the aggregate fiscal stance and the policy mix. The boxes focus on fiscal policy response to the COVID-19 pandemic in selected advanced economies, the ECB's monetary policy measures, excess private savings, and the statistical treatment of the RRF. Annex I studies longer-term fiscal sustainability implications of the plans through the lenses of the debt sustainability analysis. Annex II presents key macro-fiscal indicators available from the SCPs and the Commission 2021 spring forecast.

([2]) Articles 4(1) and 8(2) of Regulation 1466/97, on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (preventive arm of the Stability and Growth Pact).

([3]) http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf

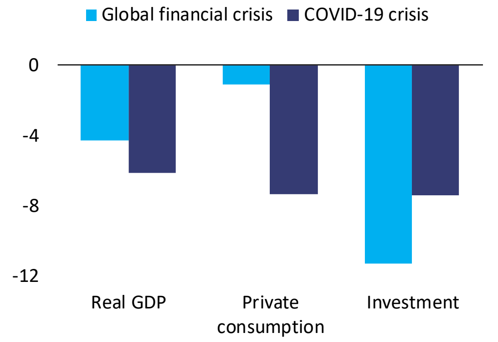
1. BUDGETARY DEVELOPMENTS IN 2020

1.1. THE COVID-19 PANDEMIC AND ITS MACROECONOMIC IMPACT

More than one year after growth in Europe was brought to a halt by the COVID-19 pandemic, the economy is starting to turn a page. The pandemic brought a dramatic loss of lives and inflicted a massive economic shock. EU economic activity contracted at an unprecedented rate of -6.1% in 2020, more than during the global financial crisis (Graph 1.1). Lockdowns and mobility restrictions imposed to curb the spread of the virus resulted in a collapse of consumer spending and investment in nearly all Member States in 2020. New waves of COVID-19 infections and virus variants in late 2020 and early 2021 delayed the rebound in economic activity. However, the pandemic is finally starting to lose its hold on Europe thanks to accelerating vaccination efforts.

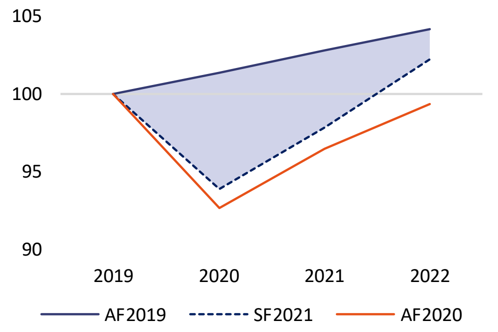
The economy is recovering considerably more quickly than expected last autumn. The collapse in economic activity was less damaging than had been expected in autumn 2020 (Graph 1.2). EU's real GDP contracted less than anticipated (1.3 pps.), with growth outturns exceeding last year's expectations for all Member States. Real GDP is now expected to return to its end-2019 level in the fourth quarter of 2021 in the EU and in the first quarter of 2022 in the euro area. However, output in 2022 will remain below the level projected for that year in the Commission's pre-pandemic forecast of late 2019. (4) The cumulated loss of EU output relative to pre-pandemic projections is forecast to be about 15% for the period 2020-2022 (the shaded area in Graph 1.2).

Graph 1.1 **Macroeconomic impact of the global financial crisis and the COVID-19 crisis on the EU economy, 2009 and 2020**
(year-on-year change, %)



Source: European Commission 2021 spring forecast.

Graph 1.2 **Real GDP growth in the EU, 2019-2022**
(index, 2019=100)



Note: The shaded area denotes the gap between the pre-pandemic forecast and the latest forecast.
Sources: European Commission 2019 autumn, 2020 autumn and 2021 spring forecasts.

1.2. BUDGETARY DEVELOPMENTS IN 2020

Exceptionally forceful fiscal support has cushioned the damaging impact of the pandemic. Thanks to the swift activation of the general escape clause of the Stability and Growth Pact (5) and of the State Aid Temporary Framework, (6) Member States have been able to provide unprecedented fiscal support in response to the pandemic, while departing from the budgetary requirements that would normally apply under the European fiscal framework. In 2020, Member States provided an unprecedented amount of fiscal support of around 6½% of GDP (7) and liquidity support of around 18% of GDP.

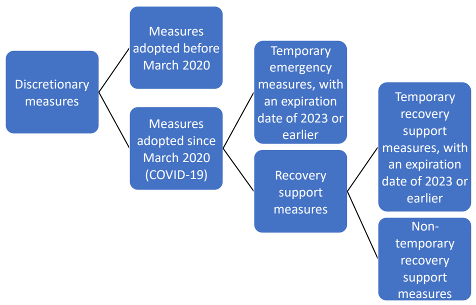
(4) At the same time, EU *potential* growth is expected to exceed the pre-pandemic projections in 2022 (by around ¼ pps.), thanks to a resilient labour market and higher total factor productivity.
(5) Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, COM(2020) 123 final.
(6) Commission Communication: Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, COM(2020) 1863 final.
(7) Measured as the year-on-year change in the EU aggregate primary general government balance.

Member States delivered fiscal support through a combination of automatic stabilisers and discretionary stimulus, complemented by sizeable liquidity support. Sizeable automatic stabilisers kicked in as soon as aggregate demand fell in spring 2020. Overall, lower tax revenues resulting from the collapse in economic activity and autonomous spending increases, in particular through the social safety nets, are estimated at about 2½% of GDP. Member States also extended discretionary fiscal support amounting to about 4% of GDP. (8) Finally, Member States provided ample liquidity support, worth around 18% of GDP, mostly in the form of public guarantees to companies and temporary tax exemption schemes. By and large, the EU fiscal response to the pandemic in 2020, together with efforts planned for 2021 and 2022, was only slight smaller than the US stimulus (Box 1.1).

Most discretionary measures with a budgetary impact in 2020 were a direct response to the pandemic. These crisis-related measures, adopted since March 2020, could be classified into two categories (Graph 1.3):

- ***Temporary emergency measures:*** These measures aimed at supporting health systems and compensating workers and firms for pandemic-induced income losses. These measures were designed to keep the economy afloat and avoid economic scarring. They are by nature temporary, with an expiry date in 2023 or earlier, consistent with the expected normalisation of the public health and economic situation. (9) Despite being temporary, they are not considered one-offs under the EU fiscal framework due to their multi-annual nature.

Graph 1.3 **Typology of discretionary measures**



Note: The graph shows how discretionary measures with a budgetary impact in 2020 or later are classified throughout this publication.

- ***Recovery support measures:*** All other crisis-related measures, either temporary or permanent, are classified as recovery support measures. These measures include public investment and other spending focused on ensuring a sustainable recovery. This category also includes measures that weigh on public finances beyond 2022 (although some of them might be offset by compensatory measures), and could therefore not be considered as temporary emergency measures. Some recovery support measures are financed by the EU budget, especially as of 2021.

The economic downturn and forceful fiscal policy response has led to an unprecedented increase in headline deficits. The EU aggregate general government deficit increased from historically low levels of around 0.5% of GDP in 2019 to around 7% in 2020, a markedly higher increase than in the immediate aftermath of the global financial crisis (Graph 1.4). Headline deficits exceeded the 3% of GDP Treaty reference value in all Member States except Denmark. Ten Member States recorded deficit levels above 8% of GDP. The highest deficit increases occurred in Greece, Malta, Austria and Spain; the lowest in Sweden, Latvia and Finland.

(8) Total revenues as a share of GDP increased by 0.4 pps. in 2020 relative to 2019, due to revenue windfalls, while total expenditure-to-GDP rose by 6.8 pps., mainly due to discretionary measures and the denominator effect.

(9) In this note, all measures with a budgetary impact in 2023 that is below 10% of the initial budgetary impact are considered temporary.

Box 1.1: Fiscal policy response to the COVID-19 crisis in the EU and the United States

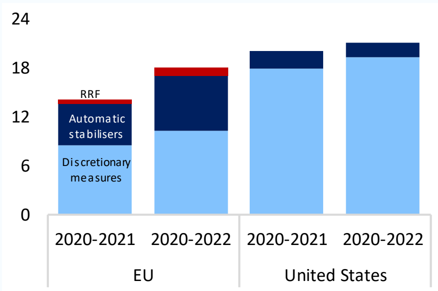
The global fiscal policy response to the COVID-19 crisis has been extraordinarily large and fast. Governments around the world “acted big” to support their health care systems, protect jobs and assist viable firms during the acute phase of the pandemic. This box compares the fiscal efforts of two large advanced economies: the EU and the United States.

A meaningful comparison of the EU and the US fiscal responses needs to account for three differences between the two economies:

- ***Government functions and relative size:*** Unlike the United States, the EU is not a federal state. The relative sizes of the US federal and state governments are very different from the sizes and roles of the EU and Member States’ budgets.
- ***Automatic stabilisers:*** The EU Member States have more developed welfare systems, which provide automatic protection to citizens during difficult times, with less need for discretionary response from governments. These automatic fiscal stabilisers provided significantly more support in Europe than in the United States. The US fiscal response had to cover some of these safety net gaps and that contributed to the size of the discretionary fiscal response.
- ***Types of support:*** A larger part of support to firms in the EU took the form of state guarantees, which are not immediately reflected in the budgetary figures. The volume of guarantees and liquidity support in the EU has been around three times as large as that in the United States.

This analysis encompasses the support provided by automatic stabilisers, discretionary fiscal measures financed by the national budgets and the RRF. The support is measured through the lenses of the cumulative estimated change in the *primary budget balance* over the period 2020-22 relative to 2019. This metric approximates the effective fiscal policy impulse in response to the crisis, including temporary measures that were introduced and expired (or are expected to expire) over this period, as well as the support provided by automatic stabilisers. In addition, the analysis includes the impulse to aggregate demand from the RRF grants, which is not captured by deficit figures compiled at national level (Box 2.3).

Graph 1 **Cumulated fiscal support in the EU and the United States, 2020-2022**
(% of GDP)



Note: In the EU, automatic stabilisers are measured as the residual between the total national support and the discretionary measures (section 2). In the United States, automatic stabilisers are assumed to provide ⅓ pp. of support for 1 pp. of GDP loss. The share of automatic stabilisers in the total support is subject to assumptions and estimation errors but the total figure is calculated directly from the public finance statistics.
Sources: European Commission 2021 spring forecasts, and International Monetary Fund’s April 2021 forecasts.

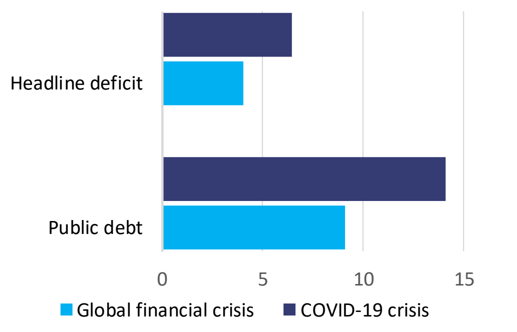
The fiscal response in the United States has been somehow stronger than in the EU. The US stimulus is projected at 21.1% of GDP in 2020-2022, compared to 18.0% in the EU (Graph 1). Back of the envelope calculations suggest that automatic stabilisers will provide about 40% of the fiscal impulse in the EU but only 10% in the US. In the EU, the RRF will contribute almost 1% of GDP. Both economies, but especially the United States, will deliver most of fiscal support in 2020-2021. However, the US figure for 2022 may increase further if the Biden administration’s ‘American Jobs Plan’ and ‘American Families Act’ are adopted (these programs, currently under discussions, are not included in the calculations).

(Continued on the next page)

Box (continued)

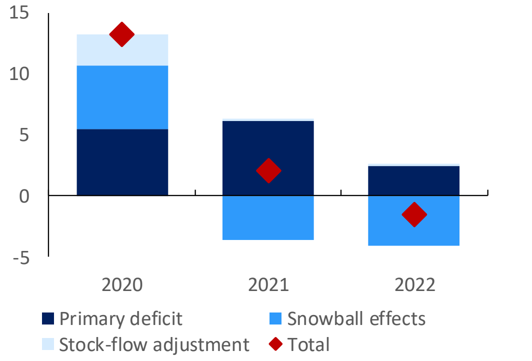
While the absolute size of fiscal support matters, so does its composition, timing and quality. On *composition*, the EU has provided more targeted emergency support, thanks to the larger automatic stabilisers and the ramping up of short-time work schemes to protect employment. In contrast, the United States provided broad (less targeted) emergency income support in 2020-2021. As the health emergency abates (*timing*), the focus of support should increasingly shift from emergency relief to building longer-term resilience, in particular by facilitating the green and digital transition (*quality*). In the EU, this is at the core of the NGEU and the RRF. In the United States, this is the focus of the 'American Families Act' and the 'American Jobs Act'.

Graph 1.4 **Public finance impact of the global financial crisis and the COVID-19 crisis in the EU, 2009 and 2020** (year-on-year change, pps. of GDP)



Source: European Commission 2021 spring forecast.

Graph 1.5 **Decomposition of the change in the EU debt ratio, 2020-2022** (pps. of GDP)



Note: The snowball effect refers to the net impact of implicit interest rate paid on debt, inflation, and real GDP growth (that is, the interest rate-growth differential) on debt dynamics.
Source: European Commission 2021 spring forecast.

Fiscal deficits in 2020 turned out to be lower than expected, in line with the less-severe-than-anticipated economic downturn. Outturn fiscal data for 2020 revealed sizeable increases of headline deficits compared to 2019, but less than anticipated in the 2021 Draft Budgetary Plans and the Commission's 2020 autumn forecast. Deficit outturns were lower than expected in almost all Member States. The EU's aggregate headline deficit was 6.9% of GDP in 2020, compared to the 8.4% of GDP projected by the Commission 2020 autumn forecast. This outcome is driven by better-than-expected growth outcomes, which meant lower support extended through automatic stabilisers. This was only partly offset by an upward revision of the budgetary impact of fiscal measures.

Public debt surged as governments borrowed heavily to support their economies. The EU's aggregate public debt jumped by 13 pps. of GDP to reach the historic level of 92% of GDP at the end of 2020 (Graph 1.5). The increase was driven by a high primary deficit (+5.5% of GDP). An unfavourable interest rate-growth differential (snowball effect) contributed another 5 pps. of GDP while sizeable stock-flow adjustment added 2.5 pps. of GDP. More than half of Member States recorded debt ratios above the

60% of GDP reference rate at the end of 2020. In Ireland, the debt-to-GDP ratio stood just below 60% in 2020 but the debt-to-modified gross national income ratio – a more accurate measure of repayment capacity in Ireland – increased to 106%. ([10]) The highest debt ratios were observed in Greece (206% of GDP), Italy (156% of GDP), Portugal (134% of GDP), Spain (120% of GDP), Cyprus (118% of GDP), France (116% of GDP) and Belgium (114% of GDP).

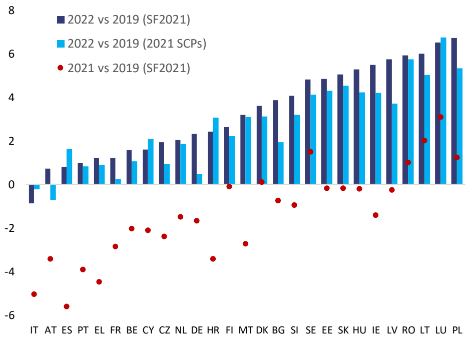
([10]) Modified gross national income (GNI*) reflects income standards of Irish residents more accurately than GDP. This measure excludes the depreciation of foreign-owned capital assets (notably intellectual property and assets associated with aircraft leasing) and undistributed profits of firms that have re-domiciled to Ireland.

2. BUDGETARY PLANS FOR 2021 AND 2022

2.1. MACROECONOMIC AND BUDGETARY OUTLOOK

Europe's economy is starting to recover from the COVID-19 pandemic. Both the Commission and the SCPs expect a strong rebound, with real GDP projected to grow by around 4% in 2021 and around 5% in 2022 (Table A2.3 in Annex). Nearly all SCPs, with the exceptions of those of Austria and Italy, expect economic activity to exceed its 2019 annual level by 2022 (Graph 2.1). In Italy, 2022 GDP is set to fall short of its 2019 level by 0.2% according to its Stability Programme and 0.9% according to the Commission. In the case of Austria, the Stability Programme expects a gap of 0.7%, while the Commission projects activity to be 0.7% higher than in 2019 (with the difference mainly reflecting different cut-off dates). In general, the Commission expects a somewhat stronger recovery by 2022 than the SCPs. However, this is not the case for Spain, Croatia, Cyprus and Luxembourg. Most Member States' forecasts were prepared or endorsed by independent fiscal institutions (Box 2.1).

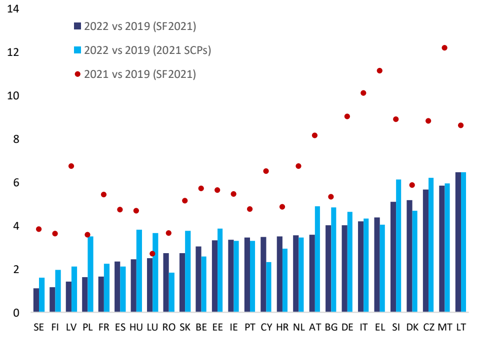
Graph 2.1 **Change in real GDP in 2021 and 2022 compared to 2019** (% of 2019 real GDP)



Note: For Ireland, the chart reflect changes in modified domestic demand. Modified domestic demand is a measure of domestic activity that strips out some effects of multinationals headquartered in Ireland. This measure is considered a more useful indicator of domestic economic conditions in Ireland than GDP.
Sources: European Commission 2021 spring forecast and the 2021 SCPs.

Despite the expected strong economic rebound, the pandemic will continue to weigh on public finances given the need to avoid an abrupt withdrawal of policy support. Headline deficits are expected to remain markedly above pre-pandemic levels (Table A2.2 in Annex and Graph 2.2). In 2021, both the Commission and the SCPs expect further deficit increases in almost half of Member States. These increases reflect additional emergency aid extended in response to new waves of the pandemic (Graph 2.3). In 2021, headline deficits are expected to remain above 3% of GDP in nearly all Member States, except in Denmark and Luxembourg. ([11]) In 2022, deficits are set to decline sharply, as the economic recovery strengthens and the temporary measures put in place during the pandemic are scaled back. However, deficits are not expected to return to their 2019 levels. Overall, the EU's headline deficit is projected to increase to 7.5% of GDP in 2021 and decrease to 3.7% of GDP in 2022, according to the Commission 2021 forecast, which is prepared on an unchanged policy basis. The SCPs, which reflect Member States' plans, envisage a slightly higher aggregate deficit of 8% of GDP in 2021 and 4% in 2022. More than half of Member States will remain above the Treaty's 3% of GDP threshold in 2022.

Graph 2.2 **Change in headline deficits in 2021 and 2022 compared to 2019** (pps. of GDP)



Sources: European Commission 2021 spring forecast and the 2021 SCPs.

([11]) Denmark's convergence programme plans a deficit above 3% of GDP in 2021.

Box 2.1: Independent assessment of forecasts underpinning the 2021 SCPs

High-quality macroeconomic forecasts improve fiscal planning. Credible macroeconomic forecasts enable realistic budgetary forecasts and contribute to debt sustainability. Recognising their importance, the EU legislation obliges Member States to use high-quality macroeconomic forecasts as inputs to their annual budgets and medium-term fiscal plans. This box examines the role of national independent fiscal institutions (IFIs) in ensuring the quality of macroeconomic forecasts underpinning the 2021 SCPs.

Mandates of national IFIs vary. In euro area Member States, these forecasts must be either endorsed or produced by national independent fiscal institutions (IFIs).([1]) In other Member States, there is no EU legal mandate for the IFI involvement but national fiscal councils can provide non-binding opinions on forecasts produced by Ministries of Finance. All Member States' national projections should also be compared to the Commission forecast.([2])

Several institutional arrangements for the production or assessment of macroeconomic forecasts exist in the euro area Member States:

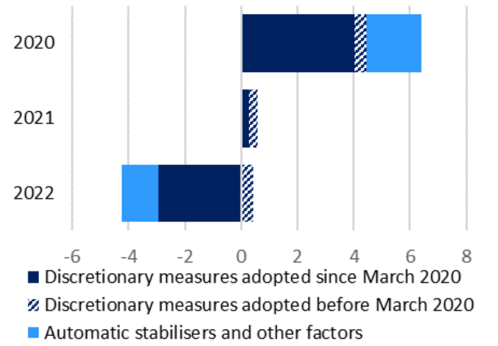
- ***Produced by IFIs:*** Macroeconomic forecasts are produced by national IFIs in five Member States (Belgium, Luxembourg, Netherlands, Austria and Slovenia).
- ***Endorsed by IFIs:*** In many euro area Member States, forecasts are produced by Ministries of Finance and endorsed by either national IFIs (Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Lithuania, Malta and Portugal) or committees of experts (Germany and Slovakia). In Latvia, the national IFI assesses forecasts prepared jointly by the Ministry of Finance and the national central bank.
- ***Produced by Ministry of Finance:*** In Finland, the Economics Department of the Finnish Ministry of Finance prepares an independent macroeconomic forecast in line with the EU requirements but without an official IFI endorsement. The IFI regularly assesses whether these macroeconomic forecasts are realistic and reliable.

The macroeconomic forecasts underpinning the 2021 SCPs appear realistic but are surrounded by unusually high uncertainty. The euro area IFIs and fiscal experts endorsed the forecasts as plausible. All institutions emphasised the high uncertainty related to the current health crisis, coronavirus restrictions and vaccination rates. The French IFI indicated that growth expectations were somewhat optimistic, while the Spanish and Italian IFIs identified some downward risks. Outside the euro area, IFIs typically review macroeconomic forecasts underpinning annual budgets but not always the forecasts underpinning Convergence Programmes. This year, the only exception is the Czech Budgetary Committee, which assessed the recent forecast produced by the Czech Ministry of Finance as realistic.

([1]) Art. 4(4) of the Two-Pack Regulation (EU) No 473/2013.
([2]) Art. 4(1) of the Council Directive 2011/85.

The aggregate debt ratio is expected to peak in 2021. On the basis of the SCPs, the EU's aggregate debt-to-GDP ratio is set to rise further, from 92% in 2020 to 95.3% in 2021, and then slightly recede to 93.6% in 2022 (Table A2.1 in Annex). This is marginally above the Commission forecast, which projects the aggregate debt ratio at 94.4% of GDP in 2021 and 92.9% of GDP in 2022. High primary deficits will continue to drive debt dynamics, partly offset by favourable interest rate-growth differentials as of 2021 (Graph 1.6). The debt ratio is expected to remain over 100% of GDP in seven Member States (Belgium, Greece, Spain, France, Italy, Cyprus and Portugal), up from three Member States before the pandemic. Annex I presents the updated assessment of risks to debt sustainability.

Graph 2.3 **Drivers of annual changes in the EU headline deficit: 2020-2022**
(pps. of GDP)



Note: In this graph, automatic stabilisers and other factors are measured as residual items. Positive values denote deficit-increasing measures.
Source: European Commission 2021 spring forecast.

Uncertainty remains high, with risks to the economic outlook broadly balanced. The evolution of the pandemic remains uncertain and will depend on the efficiency and effectiveness of vaccination programmes. Post-pandemic consumer spending is also highly uncertain: the projections might overestimate the propensity of households to spend or, alternatively, underestimate households' preference to reduce high levels of precautionary savings. The timing of policy support withdrawal, which could jeopardise the recovery if done prematurely or increase unwarranted side effects if done too late (e.g. the creation of market distortions and barriers to exit of unviable firms), represents another risk. Corporate distress could impact the labour market and the financial sector more than anticipated, while causing larger-than-expected calls on guarantees and thus a further increase in deficit. On the upside, stronger-than-projected global growth, particularly in the United States, could accelerate the recovery in Europe.

Member States face a number of country-specific risks. States with large tourism sectors face uncertainty over the easing of travel restrictions, both in Europe and globally. Countries set to benefit from significant RRF grants could face absorption challenges, with a slower-than-expected absorption slowing growth over the coming years. Member States with large financial sectors face greater risks associated with a rise in the level in bankruptcies.

2.2. EVOLUTION OF NATIONAL BUDGETARY POSITIONS

As usual, the assessment of changes in national budgetary positions is based on the dynamics of aggregate expenditure. While a bottom-up approach, stacking up the costs of individual measures, is very informative about the size and composition of the policy reactions to the COVID-19 crisis, the change in budgetary position needs to be measured using an expenditure aggregate (top-down approach). The top-down approach is the one usually followed in fiscal surveillance to measure the underlying discretionary fiscal policy run by Member States (which excludes the automatic stabilisers). This concept has been around for many years and this time is no exception. Unlike the bottom-up approach, the analysis of aggregate spending dynamics requires no assumptions on the cost of spending measures compared to a scenario without policy action. The aggregate spending dynamics (in the top-down approach) are easier to measure and take into account the fiscal trend of existing measures. However, this concept needs to be adapted to the current macro-fiscal circumstances.

2.2.1. Looking at the measures: a bottom-up approach

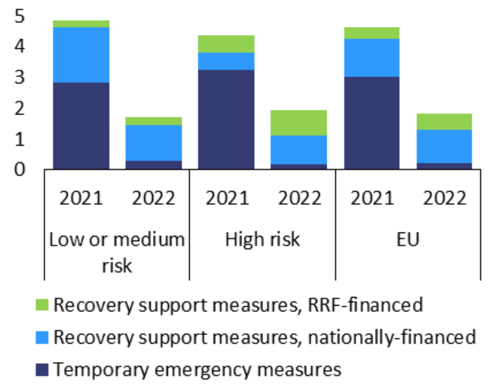
Discretionary fiscal measures adopted as a direct response to the pandemic are expected to continue to contribute to fiscal support in 2021 and 2022. As discussed in section 1.2, these fiscal measures take the form of:

- **Temporary emergency measures**, aimed at supporting health systems and compensating workers and firms for pandemic-induced income losses. They are by nature temporary, with an expiry date in 2023 or earlier. ([12])

- **Recovery support measures**, including public investment and other measures that focus on ensuring a sustainable recovery. These measures can be either temporary or permanent, and some may be funded by RRF grants.

Temporary emergency measures, which represent over half of total discretionary fiscal measures in 2021, are projected to be mostly phased out in 2022 (Graph 2.4). Total discretionary fiscal measures adopted since March 2020 are expected to amount to 4.6% of GDP in 2021 and 1.8% of GDP in 2022. Based on a preliminary assessment of available measures, this year-on-year decrease is driven by the gradual decline of temporary emergency measures, from 3% of GDP in 2021 to 0.2% of GDP in 2022. Consistent with the expected normalisation of the public health and economic situation, temporary emergency measures are projected to expire in 2023. This phasing-out is contingent on the evolution of the pandemic and the expected withdrawal of these measures should not be considered as an improvement in the underlying fiscal position. The appropriateness of their deployment and duration should be gauged in connection with the public health situation and related societal restrictions, as opposed to the state of the economy.

Graph 2.4 **Discretionary fiscal measures and medium-term fiscal sustainability risk in the EU, 2021 and 2022** (% of GDP)

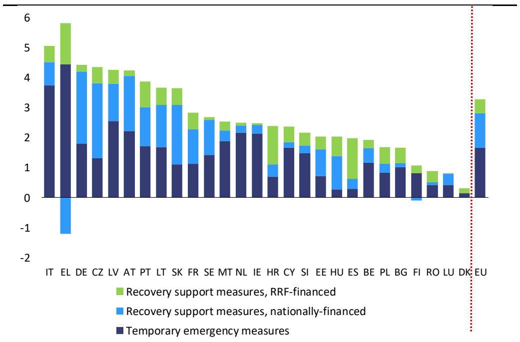


Note: Member States are clustered according to their medium-term fiscal sustainability risks, with Belgium, Greece, Spain, France, Italy, Portugal and Romania in the high-risk category.
Source: European Commission 2021 spring forecast.

([12]) In this note, measures with a budgetary impact in 2023 that is below 10% of the initial budgetary impact are considered temporary.

Most countries are expected to pivot towards recovery support in 2022. The cost of recovery support measures, in part funded by RRF grants, is expected to be around 1½% of GDP in 2021 and 2022. Member States facing low and medium risks to debt sustainability are expected to spend twice as much on these measures as high risk countries in 2021, although this is expected to equalise in 2022, according to the Commission forecast (Graph 2.4). Six Member States are projected to maintain temporary emergency measures of 2% of GDP or more in 2022, while several other countries plan none in 2022 (Graph 2.5).

Graph 2.5 **Temporary emergency measures and recovery support measures, 2021-2022** (% of GDP)



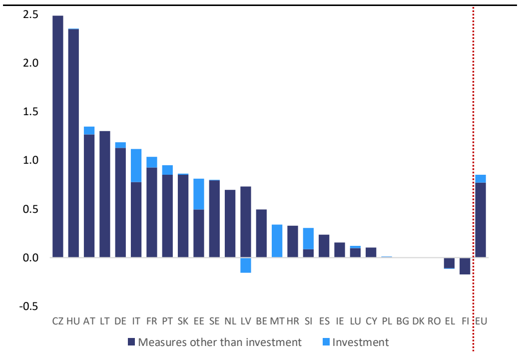
Note: The chart shows the average cost in 2021 and 2022 of measures adopted from 2020 onwards.
Source: European Commission 2021 spring forecast.

Some measures taken during the pandemic will affect public finances beyond 2022 (Graph 2.6). Even though most measures that have been taken since the outbreak of the pandemic are either temporary or financed by other (revenue-increasing or expenditure-decreasing) measures, they will still amount to 0.9% of GDP in 2023. In seven Member States, that impact will exceed 1% of GDP. These residual measures mainly consist of public sector wage increases (including for health care workers), higher pensions and social benefits, and reductions in personal income taxes and social security contributions. Some non-temporary measures will finance public investment, thus supporting potential growth and fiscal sustainability. Member States do not seem to plan to extend temporary emergency measures beyond 2023 according to the 2021 SCPs.

2.2.2. The underlying change in fiscal position and its components

The assessment of Member States' fiscal positions is based on the dynamics of general government expenditure, as in the past. This is the basis of the approach used as the main indicator of fiscal surveillance, namely the expenditure benchmark, which looks at the growth in primary expenditure net of discretionary revenue measures. Unlike a bottom-up approach based on the summing up of individual fiscal measures (as described above), the expenditure benchmark reflects aggregate spending developments, which are influenced by new measures and the evolving cost of existing measures. Focusing on the expenditure benchmark rather than the change in the structural balance, which is another indicator of fiscal surveillance, is even more warranted at the current juncture due to significant uncertainty surrounding output gap estimates.

Graph 2.6 **Non-temporary measures, 2023** (% of GDP)



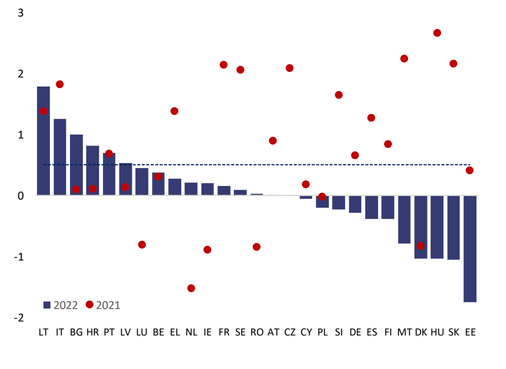
Note: The graph shows discretionary measures adopted or credibly announced from March 2020 onwards, which are not set to expire in 2023 or earlier. By and large, these measures aim to support the economic recovery post-pandemic. Measures to be financed by RRF grants are excluded.
Source: European Commission 2021 spring forecast.

The COVID-19 pandemic poses specific challenges to the assessment of the underlying fiscal position, not least the need to take into account the phasing-out of temporary emergency measures. The implementation and subsequent phasing-out of sizeable temporary emergency measures in 2022 blurs the reading of underlying fiscal developments. The phasing out of these measures should not be considered as restrictive fiscal policy, when economic activities and hours worked return to normal levels. Excluding them from the analysis will help to avoid misleading inferences on the evolution of demand support since the start of the pandemic. ([13]) This approach was also followed in the assessment of the 2021 Draft Budgetary Plans.

The need for fiscal policy to remain prudent while being conducive to a sustainable recovery justifies distinguishing between nationally-financed current expenditure and public investment. With fiscal policy recommendations in the context of the currently still exceptionally high degree of uncertainty remaining predominantly qualitative in nature, the Commission has differentiated its fiscal guidance for both types of expenditure. The growth of nationally-financed current expenditure (net of discretionary revenue measures) should be kept under control, and be limited for Member States with high debt. At the same time, the COVID-19 crisis has made it even more crucial to enhance the level and quality of sustainable and growth-enhancing investments, consistent with serving the objectives of enhancing growth potential, economic and social resilience and the green and digital twin transition. The RRF roll-out will contribute to these efforts.

The change in nationally-financed current expenditure compared with potential growth trends highlights developments in the underlying fiscal position. Consistent with the expenditure benchmark, expenditure is defined in primary terms (without interest payments) and net of discretionary revenue measures. In addition, as justified above, temporary emergency measures are excluded. Similar to the expenditure benchmark, the growth of net primary current spending is compared to the medium-term nominal potential growth rate (10-year average). ([14,15])

Graph 2.7 **Growth of nationally-financed current expenditure, 2021 and 2022** (% of GDP; in excess of medium-term potential growth)



Note: This expenditure aggregate is defined in primary terms and net of discretionary revenues. Temporary emergency measures are excluded.
Source: European Commission 2021 spring forecast.

In most Member States, the projected increase in nationally-financed current expenditure exceeds the medium-term potential growth rate in 2021 and 2022 (Graph 2.7). According to the Commission 2021 spring forecast, two high-debt Member States (Italy and Portugal) are expected to increase nationally-financed current expenditure (as defined above) by 0.5 pps. of GDP or more above their medium-term potential growth rate in both 2021 and 2022. Bulgaria, Croatia, Latvia and Lithuania are also projected to record increases of 0.5% of GDP or more in 2022, on top of some earlier increases (especially in Lithuania). By contrast, Denmark, Estonia, Ireland, Luxembourg, Netherlands, Poland and Romania are expected to restrain somewhat the growth of their nationally-financed current expend

([13]) These temporary emergency measures are to be seen not only as supporting aggregate demand but also as providing *ex post insurance* to workers and firms, whose activities are hampered by the pandemic and containment measures. While essential to keeping households and firms afloat and avoiding permanent scarring, the short-term multipliers of temporary emergency measures are likely to be lower than those associated with recovery measures. This appears to be confirmed by the sharp rise in the private sector's propensity to save (rather than consume) in 2020.

([14]) The focus on current expenditure developments means that both a decrease and increase in investment are not taken into account when assessing the change in a Member State's fiscal position. Any reduction in nationally-financed investment would, therefore, not be assessed as an adjustment in the underlying fiscal position and would not allow for a higher growth of (net) current expenditure. Contrary to a golden rule, the envisaged focus on current expenditure developments will not enable permanently higher fiscal deficits. Member States will still have to bring their deficit below 3% of GDP and/ or resume their adjustment paths towards prudent fiscal positions when economic conditions allow. Any permanent increase in investment will ultimately have to be offset by a permanent reduction in current expenditure or higher revenues.

([15]) Investment is not smoothed over four years, as is the case in the standard expenditure benchmark, as this would not facilitate a proper assessment of the contribution of public investment to the recovery. This was already in the case of the discretionary fiscal effort used to assess the fiscal stance in previous editions of this publication (see also section 3).

Box 2.2: The RRF in the Commission forecast and the SCPs: Conceptual framework and assumptions

Eurostat issued draft guidance on the statistical treatment of the RRF in national accounts in November 2020.(1) The guidance focuses on the recording of grants, loans and EU-issued debt:

- ***The timing of grant disbursements is budget-neutral:*** RRF grants should be recorded under the 'principle of neutrality': similarly to other EU grants, RRF grants should be recorded as government revenue at the same time as the expenditure financed by these grants. Thus, the timing of cash disbursements should have no impact on headline balances. This principle may not apply to grants issued retroactively for expenditure incurred in 2020.
- ***Loans are recorded as Member States' debt:*** RRF loans to Member States should be recorded as Member States' debt towards the EU. No expenditure neutralisation will take place.
- ***The RRF-related borrowing constitutes EU debt:*** The Commission will raise funds on capital markets to finance the RRF. This debt, raised on behalf of the EU, is considered EU debt.

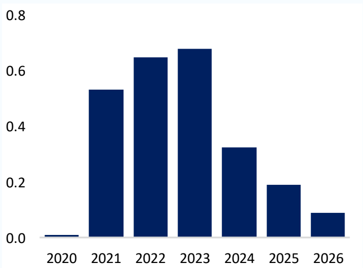
Public spending financed by RRF grants is integrated into the Commission 2021 spring forecast. The Commission followed Eurostat's guidance. In addition, grants for expenditure incurred in 2020 were recorded as revenue in 2021. The Commission also made two additional assumptions:

- ***Uniform absorption of RRF grants over time:*** The forecast assumed a linear absorption of the full RRF allocation, starting from the second half of 2021 and ending in 2026.
- ***Split of RRF grants between public and private investment:*** The forecast assumed that RRF grants would be used for public investment and capital transfers (which mainly support private investment).

The forecast deviated from these assumptions whenever sufficiently detailed and credible information on (draft) RRPs was available at the forecast cut-off date. Overall, the Commission 2021 spring forecast projects that around 40% of RRF grants would be spent by the end of 2022. During this period, close to 30% of RRF grants would support public investment, a half would boost private investment (through capital transfers) and the remainder would finance current spending and other costs.

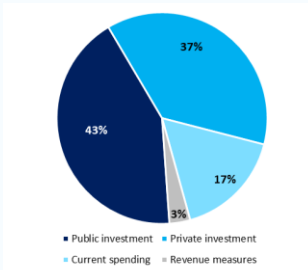
Most Member States incorporated the impact of the RRF in their 2021 SCPs, except for Belgium, Luxembourg, Netherlands, Poland and Sweden. France provided no data on the absorption profile or composition of expenditure. The reporting Member States plan to frontload spending financed by RRF grants, with nearly 50% of grants earmarked for 2021-2022 (Graph 1). RRF grants will mostly support public and private investment (Graph 2), with current spending amounting to 17% of the total envelope and revenue measures to only 3%.

Graph 1 **EU: Absorption of RRF grants, 2020-2026** (% of GDP)



Note: Belgium, France, Luxembourg, Netherlands, Poland and Sweden are not included.
Source: 2021 SCPs.

Graph 2 **EU: Costs financed by RRF grants, 2020-2026** (% of total costs)



Note: Belgium, France, Luxembourg, Netherlands, Poland and Sweden are not included.
Source: 2021 SCPs.

(1) https://ec.europa.eu/eurostat/documents/10186/10693286/GFS-Draft-guidance-note-statistical-recording-recovery-resilience-facility.pdf

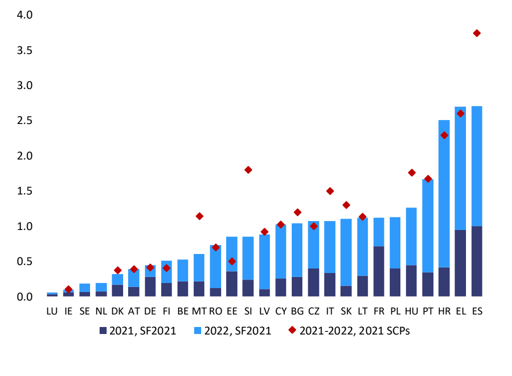
2.3. ANALYSING THE COUNTRY-SPECIFIC FISCAL STANCE

The fiscal stance indicates the short-term impact of fiscal policy on the economy. To assess the fiscal stance at the current juncture, sizeable transfers from the EU budget (such as those from the RRF) should be included. On top of EU-financed investment, the stance also includes the full impact of nationally-financed investment each year.

The EU budget will provide significant fiscal support to aggregate demand in 2021 and 2022. Expenditure financed by RRF grants will fund high-quality investment projects and enable productivity-enhancing reforms without giving rise to higher deficits and debt in national budgets. The magnitude of this support in 2021 and 2022 will depend on the size of Member States' grant allocations and the timing of RRF-financed expenditures (Graph 2.8 and Box 2.2).

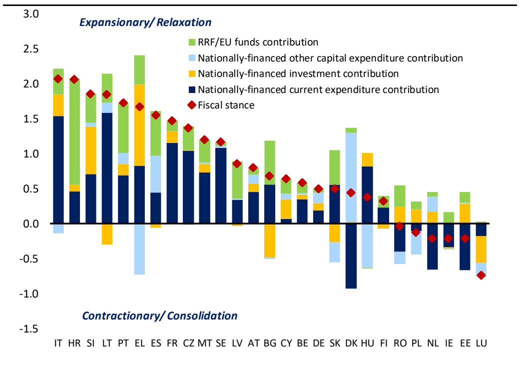
The fiscal stance, stemming from both national budgets and the EU budget, is expected to remain supportive in almost all Member States in 2021 and 2022 on average (Graph 2.9). [16] According to the Commission 2021 spring forecast, 16 Member States will provide a clearly supportive fiscal stance, with an average expansion of at least 0.5% of GDP. A broadly neutral stance is projected for Romania, [17] while slightly contractionary stances are forecast for Estonia, Ireland, Luxembourg, Netherlands and Poland. Nationally-financed investment is projected to decline in four countries (Bulgaria, Lithuania, Luxembourg and Slovakia). In several countries, in particular most of those with high medium-term fiscal risks (Greece, Spain, France, Italy and Portugal), the projected supportive fiscal stance reflects higher nationally-financed current spending (as defined in Section 2.2.2) or tax cuts.

Graph 2.8 **Expenditure financed by RRF grants, 2021 and 2022** (% of GDP)



Note: SCP data on expenditure financed by RRF grants are not available for Belgium, France, Luxembourg, Netherlands, Poland and Sweden.
Sources: European Commission 2021 spring forecast and the 2021 SCPs.

Graph 2.9 **Fiscal stance, 2021-2022** (average, % of GDP)



Note: The graph shows the fiscal stance and its components excluding COVID-19 temporary emergency measures based on the Commission forecast only as SCP data on COVID-19 temporary emergency measures are not available.
Source: European Commission 2021 spring forecast.

(16) In this note, the fiscal stance is calculated as follows to capture the whole impact of fiscal policy on short-term growth:

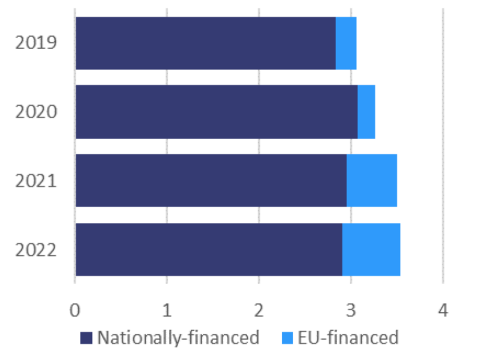
$$Fiscal\ stance\ including\ EU\ budget_t = \frac{(1 + Pot_t) * (1 + \pi_t) * E_{t-1}^{FS} - E_t^{FS} + \Delta RM_t}{Y_t}$$

where Pot indicates the 10-year average potential growth; π is inflation measured by the GDP deflator; ΔRM_t stands for the incremental budgetary impact of permanent discretionary revenue measures and E_t^{FS} is the expenditure aggregate that includes expenditure financed by the EU budget. See Glossary for details.

(17) Romania is subject to an Article 126(7) recommendation on account of unsustainable fiscal policies before the crisis.

Higher public investment will support the recovery (Graph 2.10). High-quality public investment is needed to boost growth potential, ensure a sustainable and inclusive recovery, and support the green and digital transitions. Public investment (financed by both national sources and RRF grants) is forecast to increase from 3.0% of GDP in 2019 to 3.5% of GDP in 2021 and 2022 each, according to the Commission 2021 spring forecast. In 2022, almost all Member States plan to spend more on public investment than they did before the pandemic. EU financing, mostly through RRF grants, will further boost capital spending in the EU by 0.5% of GDP in both 2021 and 2022. Differences in EU-financed investment between Member States depend on the allocation of RRF grants and the degree of absorption of those grants.

Graph 2.10 **Public investment in the EU, 2019-2022** (% of GDP)



Source: European Commission 2021 spring forecast.

This broad increase in investment is in line with the Commission's guidance to Member States. In the 2021 European Semester spring package, the Commission has recommended that all Member States maintain a supportive fiscal stance in 2022, including the impulse provided by the RRF, while preserving nationally-financed public investment. ([18]) At the same time, the growth of nationally-financed current expenditure should be kept under control, and be limited for Member States with high debt.

([18]) Commission Communication of 2 June 2021 (COM(2021) 500 final): 'Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy.'

3. FOCUS ON THE EURO AREA AS A WHOLE: THE AGGREGATE FISCAL STANCE AND THE POLICY MIX

This section focuses on the euro area as a whole, assessing the aggregate fiscal stance and the policy mix. This section looks at how fiscal and monetary policies in the euro area have responded to the COVID-19 pandemic, including the unprecedented fiscal support provided by NextGenerationEU (NGEU). The analysis also assesses the policy mix during the crisis and ensuing recovery. The analysis is mostly based on the Commission 2021 spring forecast.

The notion of the appropriate macroeconomic policy mix has evolved over time, highlighting the complementarity between fiscal and monetary policy at the current juncture. ([19]) The concept of the policy mix is traditionally related to Tinbergen's framework, where each policy objective corresponds to a separate policy instrument. However, the interaction between monetary and fiscal policies — the so-called policy mix — needs to also be considered. Different criteria can determine the optimal combination of policies: for example, the effectiveness in controlling the policy objectives or the time frame being considered (short or long term). Modern economic theory recognises the interdependence between the two policies and their substitutive nature. Hence, discretionary fiscal policy is assigned the objective of controlling the long-term path of public debt (i.e. fiscal sustainability) while the objective of controlling inflation and short-term macroeconomic stabilisation is left to monetary policy. This framework may be valid under normal conditions. However, in extraordinary circumstances, such as when monetary policy operates at the effective lower bound or in the current pandemic situation with significant macroeconomic stabilisation needs, monetary and fiscal policies are no longer substitutes but become complementary and mutually reinforcing. The main challenge in these circumstances is to preserve policymakers' credibility to maintain price stability and fiscal sustainability. Going forward, it will be important that monetary and fiscal policies regain their buffers to be able to act independently.

3.1. EURO AREA FISCAL STANCE IN 2020-2022

The assessment of the euro area fiscal stance needs to take into account the unprecedented fiscal support provided at EU level. As discussed in section 2.3, euro area economies will benefit from exceptional EU-level support extended through NGEU and especially its RRF, on top of the support from expansionary fiscal policies at national level. Expenditure financed by RRF grants does not, however, show up in the conventional indicators of fiscal surveillance. In other words, in the presence of NGEU, the business-as-usual indicator of the fiscal stance underestimates the fiscal impulse provided to aggregate demand. In order to present the full picture, the euro area fiscal stance needs to include support from the EU budget. ([20])

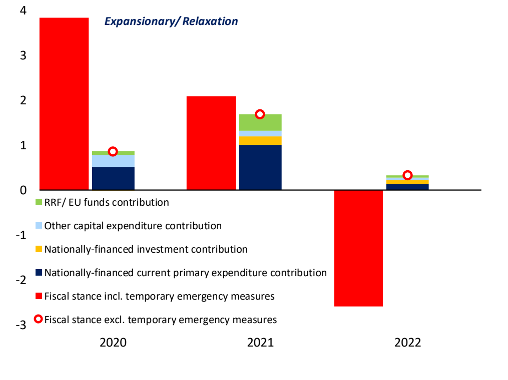
The euro area fiscal stance, excluding temporary emergency measures but including support from the EU budget, is projected to remain expansionary between 2020 and 2022. As discussed in section 2, this analysis focuses on the fiscal stance excluding temporary emergency measures related to

([19]) For an overview, see Bartsch, E, A Bénassy-Quéré, G Corsetti, and X Debrun (2020), It's all in the mix: how can monetary and fiscal policies work or fail together?, Geneva Report on the World Economy, No 23, ICMB and CEPR.

([20]) The fiscal stance indicator used in this note is in fact the discretionary fiscal effort, which has been used for analytical purposes in this publication in the past. This indicator incorporates the fiscal impulse from the EU budget, although at aggregate level its impact was negligible before NGEU. For further details on the methodology used to compile the discretionary fiscal effort, see Carnot, N. and F. de Castro (2015). 'The Discretionary Fiscal Effort: an Assessment of Fiscal Policy and its Output Effect'. European Commission, *Economic Papers 543* (February 2015).

the COVID-19 crisis. On this basis, the Commission forecast projects the overall fiscal stance of the euro area to be expansionary in all years in the period 2020 to 2022 (Graph 3.1).

Graph 3.1 **Euro area fiscal stance, 2020-2022** (% of GDP)

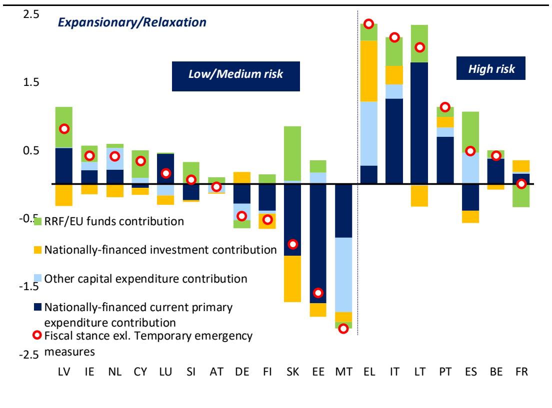


Source: European Commission 2021 spring forecast.

Both nationally- and EU-financed spending are expected to contribute to an expansionary fiscal stance in the period to 2022. In 2020, the euro area fiscal stance is estimated to have been expansionary at around ¾% of GDP. The main expansionary contribution (½% of GDP) came from the increase in nationally-financed current expenditure, followed by other capital expenditure (¼% of GDP). In 2021, the additional fiscal expansion is projected to be close to 1¾% of GDP. Nationally-financed current expenditure is expected to provide an expansionary contribution of around 1% of GDP. Other positive contributions will come from public investment and other capital spending financed by the national and the EU budgets. The expansionary contribution from the EU budget (close to ½% of GDP) mainly reflects the implementation of Member States' RRPs (Box 2.3). A further fiscal expansion of about ¼% of GDP is forecast in the euro area for 2022, with similar contributions from all components.

Fiscal policy needs to remain supportive in 2022. Economic activity in the euro area is projected to reach its end-2019 level in the first quarter of 2022, partly thanks to investments and reforms financed by the RRF. However, the pace of the recovery between Member States is expected to be uneven, with all but one Member States projected to return to the 2019 level of GDP by the end of 2022. Some countries have suffered steeper economic contractions during the pandemic than others, particularly countries more dependent on tourism. In this context, the needed fiscal support should be primarily achieved by accelerating investments (and reforms) financed by the RRF and by preserving nationally-financed public investments. All Member States, and especially high-debt countries, should pay particular attention to developments in nationally-financed current expenditure.

Graph 3.2 **Fiscal stance of the euro area Member States in 2022** (% of GDP)

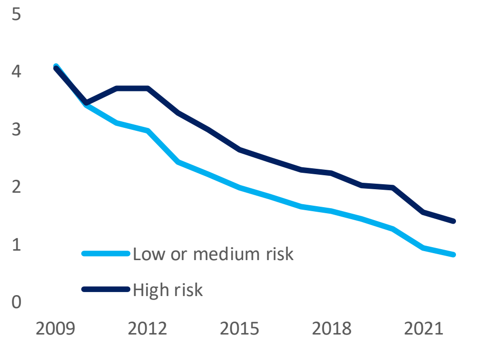


Source: European Commission 2021 spring forecast.

While fiscal stances differ significantly across Member States, the projected aggregate fiscal stance in 2022 appears broadly appropriate. The fiscal stance is projected to remain slightly expansionary in 2022, at 0.3% of GDP, contributing to a significantly supportive fiscal policy over 2020-2022 (around 1% of GDP each year, on average). This assessment also takes into account the positive impact on aggregate demand from the unwinding of historically-high private savings accumulated in 2020 and 2021 (Box 3.1). Given the uncertainties surrounding the forecast, fiscal policy needs to remain agile and adjust to the ever-evolving environment as needed. A tightening of Member States' fiscal positions in their 2022 budgets might lead to a contractionary stance, while a premature withdrawal of fiscal support should be avoided. Once health risks diminish, fiscal measures should gradually pivot to more targeted measures that promote a resilient and sustainable recovery. Moreover, Member States should make use of RRF financing to contribute to supporting the economic recovery, fostering higher potential growth and gradually improving their underlying fiscal positions. Increased differentiation in fiscal guidance to Member States should go hand-in-hand with an overall supportive fiscal stance in 2022.

The composition of the projected fiscal stance could be improved across countries and expenditure types. Member States with low and medium sustainability risks should pursue a supportive fiscal stance, in particular by making use of the RRF to finance additional investment. At the same time, they should keep the growth of nationally-financed current expenditure under control. Member States with high fiscal sustainability risks in the medium term should use the RRF to finance additional investment in support of the recovery while pursuing a prudent fiscal policy. Specifically, they should limit the growth of nationally-financed current expenditure. As discussed in Section 2.3, four euro area Member States are projected to increase their current expenditure in 2022 above their medium-term potential growth rate of more than 0.5% of GDP (two Member States with high medium-term risks, Italy and Portugal, and two Member States with low/ medium medium-term risks, Latvia and Lithuania). By contrast, low medium-term risks countries could support more the euro area fiscal stance in 2022 by further increasing their nationally-financed public investments (Graph 3.2). In this context, the favourable implicit cost of debt servicing (Graph 3.3) due to very low (and even negative) long-term market real interest rates (Graphs 3.4 and 3.5) and the availability of cheap RRF loans to finance investments and reforms will help euro area Member States increase their growth prospects and achieve the green and digital transitions.

Graph 3.3 **Euro area implicit interest rate and medium-term fiscal sustainability risk, 2009-2022** (%)

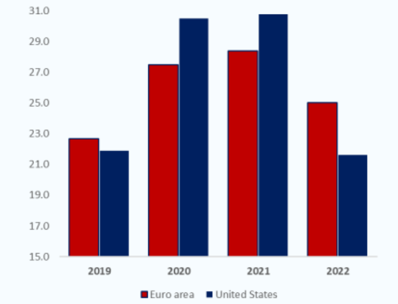


Note: The implicit interest rate is calculated as an average effective interest rate on public debt.
Source: European Commission 2021 spring forecast.

Box 3.1: Savings vs investments in the euro area and the United States, and the impact of the RRF

The COVID-19 crisis has triggered a significant increase in private savings in the euro area and the United States (Graph 1). Private incomes have remained fairly stable during the pandemic, in part due to unprecedented income support extended by governments to households and firms, including through the job retention schemes put in place by Member States and supported by the EU. However, restrictions on economic activity and heightened uncertainty have spurred a significant reduction in consumer spending. The impact of these countervailing effects can be seen in a diverging trend between consumers' propensity to save and their perceived financial situation. As a result, private savings increased by almost 5 pps. of GDP in the euro area and about 8 pps. of GDP in the United States between 2019 and 2020.(1) Based on the Commission 2021 spring forecast, private savings are expected to remain at historically high levels in both economies in 2021. In 2022, private savings are set to fall to below the pre-crisis level in the United States but remain high in the euro area (around 2.5 pps. of GDP higher than in 2019). This gives scope for a stronger-than-forecast rebound in private consumption and investments in the euro area, especially if confidence continues to improve.(2),(3)

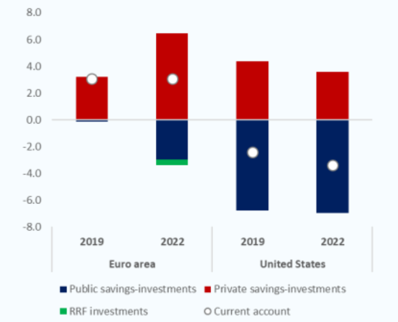
Graph 1 **Private savings in the euro area and the United States, 2019-2022** (% of GDP)



Source: European Commission 2021 spring forecast.

The current account, which measures the difference between savings and investments in the economy, is set to remain stable in the euro area in 2022 compared with 2019, as growing public and RRF-financed investments offset higher savings (Graph 2). This accounting exercise shows that higher private savings and low private investment imply that the excess savings in the euro area private sector is set to rise above its pre-crisis level (by around 3¼% of GDP in 2022). Private sector spending restraint is expected to be offset by the public sector, which is projected to continue to support the economy. The savings/investments balance in the public sector is, therefore, forecast to remain significantly negative at -3% of GDP in 2022 (from -0.1% in 2019), also due to nationally-financed public investment (½ pps. of GDP higher than in 2019). RRF grants will further support higher investments (0.4% of GDP in 2022).(4) Put together, the euro area current account surplus is projected to remain in 2022 at its 2019 level (3.1% of GDP). In contrast, the US current account deficit is expected to increase to around 3.5% of GDP in 2022, a 1 pp. of GDP increase compared to 2019, with lower private sector excess savings as the main driver.

Graph 2 **Savings-investment balance in the euro area and the United States in 2019 and 2022** (% of GDP)



Source: European Commission 2021 spring forecast.

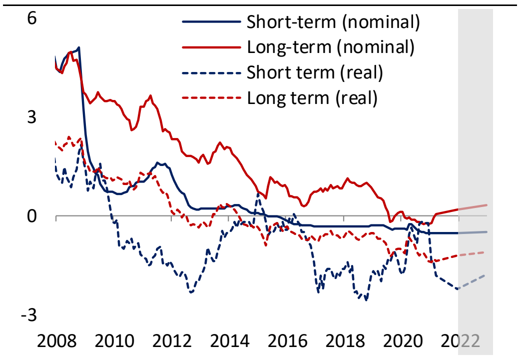
(1) The saving rate of households (in % of disposable income) increased by around 7 pps. in the euro area and 10 pps. in the United States in 2020.
(2) For more details, see the special issue 'The role of savings in determining the recovery path' in Commission 2021 spring forecast, p. 45 and the *Quarterly Report on the Euro Area (QREA), Vol. 20, No. 2 (2021), Box I.1*.
(3) The expectation of a return to more normal levels of private savings after COVID-19 is in line with the findings in Dossche and Zlatanos (2020) 'COVID-19 and the increase in household savings: precautionary or forced?' *ECB Economic Bulletin, Issue 6/2020.*
(4) The Commission forecast for the euro area current account in 2022 is the aggregate of the 19 Member States' savings and investments, including those financed by the RRF. This forecast reflects a technical assumption that public and private investments financed by RRF grants are funded through capital transfers from EU institutions. The current account of EU institutions is not included in the forecast. If the impact of RRF current transfer on EU institutions were included, the current account surplus would decline from 3.1% of GDP in 2019 to 3.0% of GDP in 2022.

3.2. MONETARY POLICY STANCE IN 2020-2022

The European Central Bank (ECB)'s monetary policy measures have helped mitigate the adverse economic effects of the COVID-19 pandemic. With its policy rates close to their effective lower bound, the ECB's monetary policy response has consisted mainly of additional assets purchases and liquidity-provision operations to euro area banks (Box 3.2). To enhance banks' access to these operations, the ECB also took a number of measures to ease collateral requirements. Sizeable asset purchases and high take-up of liquidity-provision operations have led to a large expansion of the Eurosystem balance sheet (Graph 3.5). Between February 2020 and May 2021, the Eurosystem balance sheet increased by around €3 trillion, to about €7.6 trillion (64% of euro area GDP).

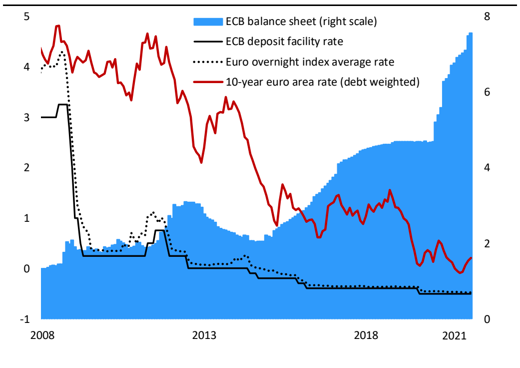
ECB measures have further eased the monetary policy stance and contributed to preserving financial stability in the euro area, thus supporting the transmission of fiscal policy measures. Additional asset purchases have contributed to the stabilisation of both government and corporate bond yields, thus helping to avoid fragmentation in euro area debt markets. In turn, favourable financing costs for governments have facilitated the issuance of large amounts of sovereign debt at historically low interest rates. After a temporary spike at the start of the pandemic, long-term government bond yields and intra-euro-area bond yield spreads have gradually declined, moving below their pre-crisis levels by the end of 2020. In 2021, long-term government bond yields have increased slightly, reflecting an improved economic outlook and a global reassessment of inflation risks. However, their levels remain historically low and the increase has not affected intra-euro-area bond yield spreads and bank lending rates. Lower long-term nominal interest rates have also translated into historically-low real interest rates, which impact non-financial corporations' and households' decisions on investment and consumption (Graph 3.4). Reflecting these trends, borrowing costs for households and non-financial corporations, as measured by composite credit cost indicators, have also declined to pre-pandemic levels (Graph 3.6).

Graph 3.4 **Euro area benchmark interest rates, 2009-2022** (%)



Note: Short-term rate: 3-month Euribor; long-term rate: 10-year interest rate swap; real rates are derived from the respective nominal rates minus annual inflation and average future inflation inferred from 10-year inflation swaps. Short-term nominal forecasts are derived from forward rates and are deflated by latest Commission inflation forecasts. Long-term nominal forecasts are derived from forward long-term swap rates and are deflated by their respective forward inflation swaps.
Sources: Macrobond, ECB, European Commission.

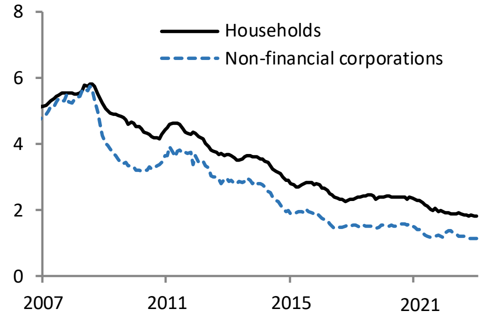
Graph 3.5 **Indicators of ECB monetary stimulus, euro overnight index average rate and 10-year euro area sovereign rate, 2008-2021** (left scale in %, right scale in trillions of euros)



Sources: Macrobond, ECB, European Commission.

The monetary policy stance is expected to remain accommodative in 2021 and 2022 but risks associated with a long period of monetary accommodation are increasing. Financing conditions are expected to remain very supportive in 2021 and 2022, supported by favourable conditions on ECB liquidity-provision operations and forward guidance on policy rates (Box 3.2). Market expectations indicate that short-term interest rates should remain close to the current level of the deposit facility interest rate (-0.50%) well beyond 2022, indicating no expectations for changes to key ECB interest rates during that period. Despite the recent increase in long-term interest rates, market expectations suggest only a gradual and modest increase over the next two years. With market participants anticipating a stabilisation of long-term inflation expectations over 2021-2022, real long-term interest rates should increase only modestly over this period. These expectations are in line with the ECB's forward guidance and communication on asset purchases and reinvestment policy (Box 3.2). ([21])

Graph 3.6 **Credit cost indicators in the euro area, 2007-2021**



Note: The composite credit cost indicators are calculated as weighted averages of interest rates on different types of bank loans and corporate bonds (in case of non-financial corporations).
Sources: BofA Securities, Bloomberg, ECB, European Commission.

([21]) The Eurosystem held about a third of outstanding sovereign bonds in the euro area at the end of 2020, with the cumulative net asset purchases ranging from around 25% of outstanding government bonds for Belgium, Italy and Malta to more than 40% for Germany, Lithuania, the Netherlands and Slovakia. The exact share of Eurosystem holdings of the outstanding euro area sovereign bonds varies depending on the calculation methods.

Box 3.2: ECB monetary policy measures since the onset of the COVID-19 pandemic

Since the onset of the COVID-19 pandemic, the ECB has adopted a broad range of supportive monetary policy measures. This box describes these measures and discusses the ECB's guidance on their continued application. The measures can be grouped into three main categories:

- **Asset purchase programmes**: In March 2020, the ECB increased its purchases under the asset purchase program (APP) by €120 billion (until the end of 2020) and launched the Pandemic Emergency Purchase Programme (PEPP). In December 2020, the PEPP envelope was increased to €1.85 trillion and its duration extended to at least March 2022. Total purchases of public and private sector assets under the two programmes amounted to around €1.4 trillion (about 12% of 2019 euro area GDP) between March 2020 and April 2021. These programmes helped stabilise euro area financial markets in the early stages of the COVID-19 pandemic and prevented a tightening of financing conditions across euro area Member States.

- **Liquidity provision**: Among various liquidity-providing operations undertaken since the outbreak of the COVID-19 pandemic, the third series of targeted longer-term refinancing operations (TLTRO III) has been critical in supporting the flow of credit to firms and household. The TLTRO III have made available central bank funding at attractive conditions to euro area banks on the condition that they continue to provide lending to the non-financial private sector. As of May 2021, banks had borrowed nearly €2.1 trillion (about 18% of 2019 euro area GDP) under the TLTRO III. The ECB's Bank Lending Survey suggests that this has eased bank lending conditions and improved lending volumes. Other liquidity-providing operations, such as the additional pandemic emergency longer-term refinancing operations (PELTRO), have also been offered to ensure an effective liquidity backstop for the banking sector.

- **Easing of collateral requirements**: Collateral easing measures and a range of supervisory and prudential measures have enhanced banks' access to ECB liquidity and supported their lending capacity. These measures consisted of a widening of the pool of assets that banks can pledge as collateral with the Eurosystem in return for central bank loans, as well as a reduction of the haircuts applied on this collateral.([1]) This easing of collateral requirements has reduced risks that collateral shortages hamper banks' access to central bank loans. In parallel, the ECB and national supervisory authorities provided temporary regulatory capital relief and supervisory flexibility to the treatment of non-performing loans.

The ECB has provided extensive guidance on the duration of these policy measures and the outlook for its key interest rates. The ECB has committed to conduct asset purchases under the PEPP until at least the end of March 2022 and the Eurosystem will continue to reinvest maturing securities purchased under the PEPP until at least the end of 2023. Net purchases under the APP are also expected to continue at a monthly pace of €20 billion for as long as necessary. This will reinforce the accommodative impact of low policy interest rates and is expected to end only shortly before the ECB starts to raise its key interest rates. The Eurosystem also intends to continue reinvesting in full the principal payments from maturing securities purchased under the APP. This is expected to remain the case for an extended period of time past the ECB's first decision to raise its key interest rates and for as long as is necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. Finally, the ECB Governing Council expects key policy rates to remain at their present or lower levels until it sees the inflation outlook robustly converge to its inflation mandate and until this convergence has been consistently reflected in underlying inflation dynamics.

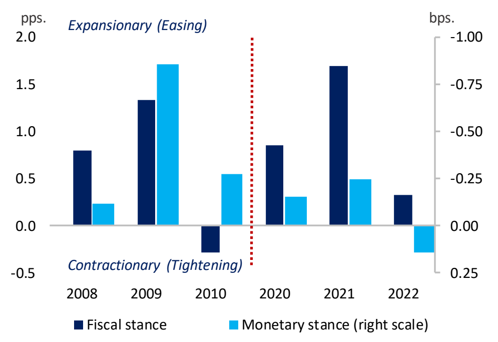
([1]) The Eurosystem applies a discount, known as the valuation haircut, to provide a buffer against potential changes in the value of collateral.

3.3. POLICY MIX IN THE EURO AREA IN 2020-2022

The mutually-reinforcing interaction between fiscal and monetary policies has limited the economic damage of the COVID-19 pandemic and is supporting the recovery. Decisive policy action from both the fiscal and monetary authorities has been essential to achieving macroeconomic stabilisation in the euro area and limiting permanent economic scarring. Support has been complementary and has created space for both policies to operate in. By preserving financial stability and maintaining favourable financing conditions in all euro area Member States, monetary policy has contributed to a more effective transmission of fiscal policy support to the real economy. At the same time, government interventions across the euro area have reduced the risk of a severe impairment of the transmission of monetary policy. In particular, income and liquidity support measures, including public guarantees for loans, have facilitated the continued provision of credit to the economy by the banking sector and an efficient pass-through of favourable financing conditions to all economic sectors. The complementary policy mix has also supported the sustainability of public finances in the euro area.

Joint fiscal and monetary policy support in response to the COVID-19 pandemic has been larger and longer lasting than that seen in the wake of the global financial crisis (Graph 3.7). While the immediate monetary and fiscal policy responses in 2008 and 2009 were strong and similarly complementary, support was withdrawn earlier and unconventional monetary policy was not deployed back then. The fiscal stance turned contractionary in 2010 as the euro area sovereign debt crisis unfolded. In contrast, the current euro area policy mix is expected to remain accommodative. Financing conditions are expected to tighten only very slightly in 2022 (Graph 3.7) but will remain more supportive in 2022 than, for instance, in 2010.

Graph 3.7 **Euro area: Policy mix during the global financial crisis and the COVID-19 crisis**



Note: Fiscal stance in measured as described in section 2. Monetary stance is measured by the change in the real long-term interest rate.
Source: European Commission 2021 spring forecast.

The synergy between the two policies remains critical for the recovery to gain traction. The transmission of the accommodative monetary policy stance will be facilitated by continued supportive fiscal policy in 2021 and 2022. Fiscal policy should avoid creating cliff-edge effects through the sudden withdrawal of support measures (both discretionary fiscal measures and liquidity support measures). Such a sudden withdrawal would deepen the risk of long-term scarring effects on the productive capacity of economies. ([22]) Tight liquidity positions continue to pose a challenge for otherwise solvent businesses that may still have to cope with possibly subdued demand, especially in the services sector. Moreover, notwithstanding historically low interest rates, the prospect of prolonged weak demand would disincentivise investment by businesses. Finally, a sudden rise in bankruptcies would adversely affect the quality of assets in banks' balance sheets and thereby also impair the effectiveness of the monetary policy transmission mechanism.

Both the horizon and the intensity of the joint policy support will need to evolve as the recovery progresses. The ECB is expected to maintain an accommodative monetary policy looking forward and financing conditions should remain very favourable in the euro area. Markets anticipate that the ECB will look through a temporary increase of the euro area inflation in the second half of this year. At the same time, the current low interest rate environment might limit the possibility for significant additional monetary expansion should it become necessary. On the other hand, as the levels of government debt have also reached historically high levels, additional support to the economy may require the policy mix to become tilted towards more targeted and differentiated support, across countries and economic sectors.

([22]) On the other hand, a too late withdrawal of fiscal support may pose unwarranted side effects.

Fiscal policy can deliver such differentiated and targeted support more effectively than monetary policy. In particular, as health risks diminish, fiscal measures should increasingly pivot away from universal income support and support transitions from crisis-induced unemployment or short-time work schemes towards other employment opportunities, especially for those unemployed and inactive. Financing for viable firms should also become more diversified towards equity and prioritise incentivising the provision of capital by the private sector. Governments should prioritise policies that boost productivity and, thereby, increase potential growth. For that purpose, it will be key to increase public and private investment, especially supporting the green and digital transitions, and implement much needed structural reforms, including to reap the benefits of higher investment spending. Finally, when economic conditions allow, fiscal policies in the Member States will need to aim at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term, while enhancing investment to boost growth potential.

ANNEX 1
Debt sustainability analysis

A1.1. INTRODUCTION

This annex assesses the sustainability of Member States' public finances based on the latest information. ([23]) The analysis uses the Commission's multidimensional framework to assess risks to fiscal sustainability. ([24]) Three inputs are used in the analysis: the Commission 2021 spring forecast, the 2021 SCPs and the 2021 Ageing Report.([25]) The Ageing Report reflects the projected cost of population ageing over the long term. Even though the Commission 2021 spring forecast takes into account the impact of the RRF, the fiscal sustainability analysis does not incorporate the longer-term growth impact of the reforms and investments financed by this facility. These reforms and investments are expected to mitigate sustainability risks.

Table A1.1: **Overall risk classification**

	Overall SHORT-TERM risk category	Overall MEDIUM-TERM risk category	S1 indicator - overall risk assessment	Debt sustainability analysis - overall risk assessment	S2 indicator - overall risk assessment	Overall LONG-TERM risk category
BE	HIGH	HIGH	HIGH	HIGH	MEDIUM	HIGH
BG	LOW	LOW	LOW	LOW	LOW (MEDIUM)	LOW (MEDIUM)
CZ	LOW	MEDIUM (LOW)	MEDIUM (LOW)	MEDIUM (LOW)	MEDIUM	MEDIUM
DK	LOW	LOW	LOW	LOW	LOW	LOW
DE	LOW	LOW	LOW	LOW	LOW (MEDIUM)	LOW (MEDIUM)
EE	LOW	LOW	LOW	LOW	LOW	LOW
IE	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM
EL	HIGH	HIGH	HIGH	HIGH	LOW	MEDIUM
ES	HIGH	HIGH	HIGH	HIGH	LOW	MEDIUM
FR	HIGH	HIGH	HIGH	HIGH	LOW	MEDIUM
HR	HIGH	MEDIUM	LOW	MEDIUM	LOW	MEDIUM
IT	HIGH	HIGH	HIGH	HIGH	LOW	MEDIUM
CY	HIGH	MEDIUM	LOW	MEDIUM	LOW	MEDIUM
LV	LOW (HIGH)	LOW	LOW	LOW	LOW	LOW
LT	LOW	MEDIUM (LOW)	LOW	MEDIUM (LOW)	LOW	MEDIUM (LOW)
LU	LOW	LOW	LOW	LOW	HIGH	HIGH
HU	LOW	MEDIUM	MEDIUM (LOW)	MEDIUM	MEDIUM	MEDIUM
MT	LOW	MEDIUM (LOW)	LOW	MEDIUM (LOW)	MEDIUM	MEDIUM
NL	LOW	LOW (MEDIUM)	LOW (MEDIUM)	LOW (MEDIUM)	MEDIUM	MEDIUM
AT	LOW	MEDIUM	LOW	MEDIUM	LOW (MEDIUM)	MEDIUM
PL	LOW	LOW	LOW	LOW	MEDIUM (LOW)	MEDIUM (LOW)
PT	HIGH	HIGH	MEDIUM	HIGH	LOW	MEDIUM
RO	LOW (HIGH)	HIGH	HIGH	HIGH	MEDIUM (HIGH)	HIGH
SI	LOW	MEDIUM (HIGH)	MEDIUM	MEDIUM (HIGH)	HIGH (MEDIUM)	HIGH
SK	HIGH	MEDIUM (HIGH)	MEDIUM (HIGH)	MEDIUM (HIGH)	HIGH	HIGH
FI	HIGH	LOW (MEDIUM)	LOW (MEDIUM)	LOW (MEDIUM)	MEDIUM	MEDIUM
SE	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM

Notes: The classification is based on the Commission baseline scenario, which assumes a gradual reversal of temporary pandemic-related measures and the financing of permanent ones. In brackets: risk category in the 2020 Debt Sustainability Monitor when different. There was no risk classification for Greece in the 2020 Debt Sustainability Monitor.
The S0 indicator informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon.
The S1 indicator measures the effort required to bring the debt-to-GDP ratio to 60 % in 15 years. It corresponds to a cumulated improvement in the structural primary balance over 5 years compared with the baseline.
The S2 indicator shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon.
The debt sustainability analysis is performed around the Commission's baseline scenario to test the response to different shocks, including sensitivity tests and stochastic projections.
The overall medium-term and long-term risk classifications are based on both the results of the debt sustainability analysis and either the S1 or the S2 indicator.
See for more information the *2020 Debt Sustainability Monitor*
Source: European Commission.

Two scenarios are used to assess debt sustainability over the medium to long term: the Commission baseline scenario and the SCP scenario. The Commission baseline scenario is based on the Commission 2021 spring forecast and, in line with the 2020 Debt Sustainability Monitor, it implicitly assumes that pandemic-related measures extending beyond 2022 come to an end and that the permanent measures introduced since last year are offset by budgetary savings. This is reflected by the assumption of a gradual improvement in structural primary balances up to their pre-crisis forecast values as from 2023, if these have not already been reached. The SCP scenario assumes that governments fully implement the fiscal plans presented in their SCPs until the end of the programme horizon. Beyond the programme horizon, structural primary balances are assumed to revert to their pre-crisis planned values, if these have not already been reached.

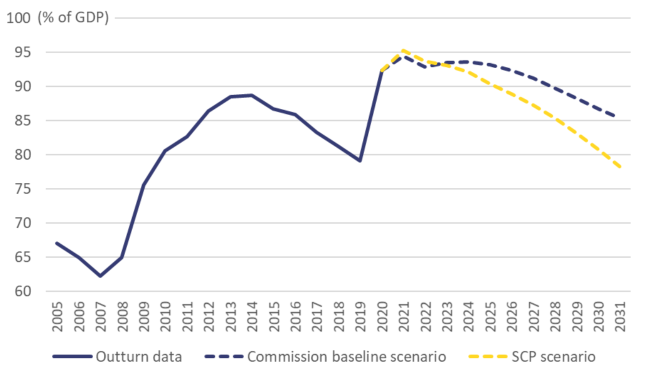
([23]) Medium-term debt developments are also discussed in the Commission report prepared in accordance with Article 126(3) of the Treaty (https://ec.europa.eu/info/publications/omnibus-report-under-art-126-3_en). This is because the medium-term debt position is part of the relevant factors that the Commission must take into account when assessing compliance with the deficit and debt criteria of the Stability and Growth Pact (see https://ec.europa.eu/info/sites/info/files/economy-finance/2_en_act_part1_v3-adopted_text.pdf). The current analysis also fed into the statistical annex to the SCP opinions published on 2 June (https://ec.europa.eu/info/sites/default/files/economy-finance/swd-2021-501_en_v2.pdf).
([24]) See the 2020 Debt Sustainability Monitor for further details on the methodology: European Commission (2021), "Debt Sustainability Monitor 2020", European Economy Institutional Paper, No. 143, February 2021, https://ec.europa.eu/info/sites/default/files/economy-finance/ip143_en.pdf.
([25]) European Commission (DG ECFIN) and Economic Policy Committee (AWG) (2021), "The 2021 Ageing Report: Economic and budgetary projections for the EU Member States (2019-2070)", *European Economy, Institutional Paper* 148, May 2021, https://ec.europa.eu/info/publications/2021-ageing-report-economic-and-budgetary-projections-eu-member-states-2019-2070_en.

A1.2. SHORT-TERM RISKS

The large government deficits recorded in 2020, resulting from the severe economic recession and the necessary policy response to the COVID-19 pandemic, have increased short-term fiscal risks for some countries. Governments' gross financing needs increased abruptly, as measures to address the COVID-19 pandemic and support the economy resulted in exceptionally large deficits. Financing needs are expected to increase further in six Member States in 2021 (Czechia, Greece, Italy, Latvia, Malta and the Netherlands) but will remain at moderate levels in three of them (Czechia, Latvia and the Netherlands). Most Member States' financing needs are expected to at least stabilise in 2022 before decreasing over the medium term. This is driven by an improvement in primary balances and favourable interest-growth rate differentials. Mainly due to their budgetary situation, 10 countries appear at short-term risk of fiscal stress according to the S0 indicator, the Commission's early-warning indicator (Belgium, Greece, Spain, France, Croatia, Italy, Cyprus, Portugal, Slovakia and Finland; Table A1.1). Compared with the 2020 Debt Sustainability Monitor, the risk classification has improved for two countries (Latvia and Romania), mainly reflecting better-than-previously-estimated fiscal outcomes in 2020. In 2009, as many as 17 countries were found to face such a risk. In most cases, the current macro-financial situation appears sounder than during the global financial crisis. Moreover, the decisive ECB interventions and EU initiatives – including NGEU – adopted in 2020 and 2021 should ensure that sovereign financing conditions remain favourable, lessening risks of short-term fiscal stress.

A1.3. MEDIUM-TERM RISKS

Graph A1.1: **Medium-term debt projections, EU**



Note: The Commission baseline scenario assumes a gradual return of structural primary balances to their pre-pandemic (2019) levels. The SCP scenario assumes that the plans presented in the SCPs are fully implemented and that, beyond the programme horizon, structural primary balances revert to their pre-crisis planned values.
Source: European Commission

The full implementation of the 2021 SCPs would lead to an earlier and faster debt reduction than envisaged in the Commission baseline scenario. The aggregate debt-to-GDP ratio is projected to decline over the medium term according to both scenarios. According to the Commission baseline scenario, general government debt would broadly stabilise at around 93% of GDP in the EU as a whole until 2024, before declining as from 2025 – benefiting from both the assumed progressive correction of the primary balance and a negative interest-growth differential – to reach 85% of GDP by 2031 (Graph A1.1). In the euro area as a whole, the debt ratio would broadly stabilise at around 101% of GDP until 2024 before gradually declining to 94% of GDP in 2031. In the SCP scenario, the decline in the debt ratio starts earlier and debt falls more markedly than in the Commission baseline scenario, in both the EU and the euro area.

Large differences across countries exist in terms of debt levels and the timing and magnitude of debt reduction. According to the Commission baseline scenario, the debt-to-GDP ratio peaked in 2020 or is expected to peak in 2021 in a majority of Member States (Graph A1.2). In most of these countries, debt ratios would fall back to their 2019 level or below by 2031, although it would remain above 100% of GDP in Portugal and above 150% of GDP in Greece and Italy. By contrast, eight countries would see their debt level peak a few years later and remain above their 2019 level in 2031 (Belgium, Czechia, Estonia, Spain, France, Lithuania, Malta and Slovakia). In Romania, debt would still increase after 2031.

Under the SCP scenario, debt levels would generally peak in the same year as in the Commission baseline scenario or earlier (although with a few exceptions) and, especially in high-debt countries, debt would decline more markedly (Graph A1.2).

Graph A1.2: **Medium-term debt projections, Commission baseline scenario and SCP scenario**

Notes: The countries are ordered first by year of peak, then by debt level at the peak. In case of multiple local peaks, the graph shows the highest one.
The Commission baseline scenario assumes a gradual return of structural primary balances to their pre-pandemic (2019) levels. The SCP scenario assumes that the plans presented in the SCPs are fully implemented and that, beyond the programme horizon, structural primary balances revert to their pre-crisis planned values.
Source: European Commission.

Table A1.2: **Revision of debt projections compared with the 2020 Debt Sustainability Monitor**

	Debt level in 2022 (% of GDP)			Debt level in 2031 (% of GDP)			Change 2022-2031	
	Spring 2021	2020 DSM	*Difference*	Spring 2021	2020 DSM	*Difference*	Spring 2021	2020 DSM
BE	115.5	118.6	*-3.1*	110.8	121.2	*-10.4*	-4.7	2.6
BG	24.0	26.3	*-2.2*	20.1	23.0	*-2.8*	-3.9	-3.3
CZ	47.1	42.2	*4.9*	58.1	43.1	*15.1*	11.0	0.9
DK	38.8	40.9	*-2.1*	24.6	24.7	*-0.1*	-14.1	-16.2
DE	72.1	69.0	*3.2*	61.0	57.1	*3.9*	-11.1	-11.9
EE	24.0	26.4	*-2.4*	23.5	31.7	*-8.2*	-0.5	5.3
IE	59.7	66.0	*-6.4*	45.2	48.3	*-3.1*	-14.5	-17.7
EL	200.1	193.1	*7.0*	163.5	155.5	*7.9*	-36.6	-37.5
ES	116.9	123.9	*-7.1*	117.4	140.6	*-23.2*	0.5	16.6
FR	116.4	119.4	*-3.1*	118.2	119.9	*-1.7*	1.8	0.5
HR	82.9	81.6	*1.3*	75.6	76.8	*-1.2*	-7.3	-4.8
IT	156.6	159.1	*-2.6*	153.0	155.8	*-2.8*	-3.6	-3.4
CY	106.6	102.8	*3.8*	80.7	82.6	*-1.9*	-25.9	-20.2
LV	46.4	45.5	*0.9*	39.0	45.3	*-6.3*	-7.4	-0.2
LT	54.0	49.5	*4.5*	60.1	42.9	*17.2*	6.1	-6.6
LU	26.8	28.9	*-2.0*	12.5	17.9	*-5.4*	-14.4	-11.0
HU	77.1	77.2	*0.0*	61.7	64.0	*-2.3*	-15.5	-13.2
MT	65.5	59.3	*6.2*	60.8	43.3	*17.5*	-4.7	-16.0
NL	56.8	65.9	*-9.1*	50.0	63.5	*-13.5*	-6.8	-2.4
AT	85.0	85.1	*-0.1*	71.2	76.3	*-5.1*	-13.8	-8.8
PL	55.1	56.4	*-1.4*	44.8	46.4	*-1.5*	-10.2	-10.1
PT	122.3	127.2	*-4.9*	105.2	107.6	*-2.4*	-17.0	-19.6
RO	52.7	63.6	*-10.9*	86.4	126.8	*-40.4*	33.7	63.2
SI	76.7	79.8	*-3.1*	70.8	79.1	*-8.3*	-5.9	-0.7
SK	58.7	67.6	*-8.9*	58.2	84.2	*-26.0*	-0.5	16.7
FI	70.1	72.5	*-2.5*	62.8	70.5	*-7.7*	-7.2	-2.0
SE	39.4	40.3	*-0.9*	22.4	30.6	*-8.2*	-17.0	-9.7
EU	**92.9**	**94.9**	***-2.0***	**85.4**	**90.1**	***-4.7***	**-7.5**	**-4.8**
EA	**100.7**	**102.6**	***-1.9***	**93.9**	**98.2**	***-4.2***	**-6.8**	**-4.5**

Note: The baseline assumptions for Greece reflect the post-programme commitments and are in line with the methodology used in the context of enhanced surveillance. For more information, see the 2020 Debt Sustainability Monitor.
Source: European Commission

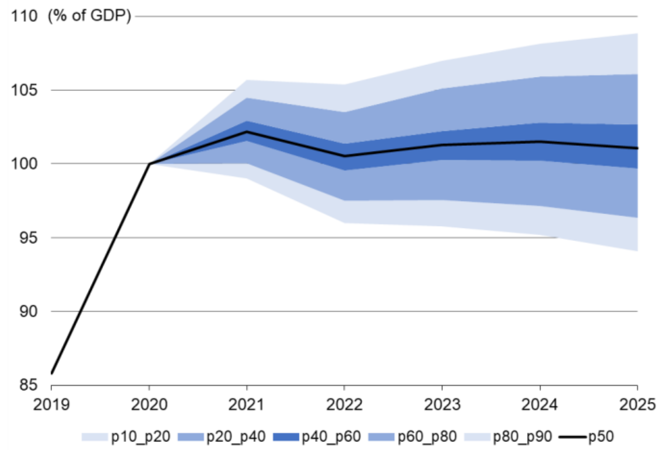
Government debt projections have improved in most countries compared with the results published in the 2020 Debt Sustainability Monitor (DSM). Compared with the DSM 2020, which was based on the Commission 2020 autumn forecast, the baseline projected debt ratio is reduced by 4.7 pps. of GDP for the EU as a whole by 2031, with lower projected debt in 22 countries (see Table A1.2). These results reflect the improvement of the economic and fiscal forecast in these countries for 2021 and 2022, in line with the expected positive impact of RRF-related expenditure at home as well as higher growth worldwide, in particular in the United States and China.([26]) The upward revision of potential growth estimates over a 10-year horizon in almost all Member States also contributes to this more favourable global outlook. The downward revision in the debt-to-GDP ratio appears particularly large for Romania (-40 pps. of GDP by 2031), Slovakia (-26 pps. of GDP), Spain (-23 pps. of GDP), and the Netherlands and Belgium (both by more than 10 pps. of GDP).

The Commission's debt sustainability analysis (DSA), which combines sensitivity tests and stochastic projections around the baseline, is the central tool to assess medium-term fiscal risks. The large degree of uncertainty implies that the set of sensitivity tests and alternative scenarios (including stochastic projections), routinely included in the Commission's multidimensional framework, is particularly relevant this year. In particular, stochastic projections, featuring the uncertainty surrounding baseline projections, suggest a significant probability that debt in the euro area will be higher in 2025 than it was in 2020 (Graph A1.3). The decision tree, assessment criteria and thresholds used for the DSA risk classification are summarised in Graphs A1.7 and A1.8.

The DSA, largely confirmed by the S1 indicator, finds that seven countries face high sustainability risks in the medium term and nine others face medium risks. The countries where medium-term sustainability risks are high include Belgium, Greece, Spain, France, Italy, Portugal and Romania (see Table A1.1). In all these countries but Romania, the results are driven by the high initial debt ratios that are projected to fall only gradually, and in some cases late, over the projection period. In the case of Romania, the high-risk classification reflects a particularly fast-increasing debt path. The nine countries facing medium risks are Czechia, Croatia, Cyprus, Lithuania, Hungary, Malta, Austria, Slovenia and Slovakia, with overall consistent signals across the different scenarios considered. The remaining 11 Member States have low sustainability risk. Compared with the DSM 2020, only a few changes took place in the risk classification. Most notably, Slovenia and Slovakia moved from the high-risk to the medium-risk category. Moreover, in most countries, fully implementing the plans presented in the SCPs would alleviate sustainability risks, as captured by the S1 indicator (Graph A1.4). On this basis, only two countries would face high risks in the medium term, while the S1 indicator based on the Commission baseline scenario identifies six high-risk countries.

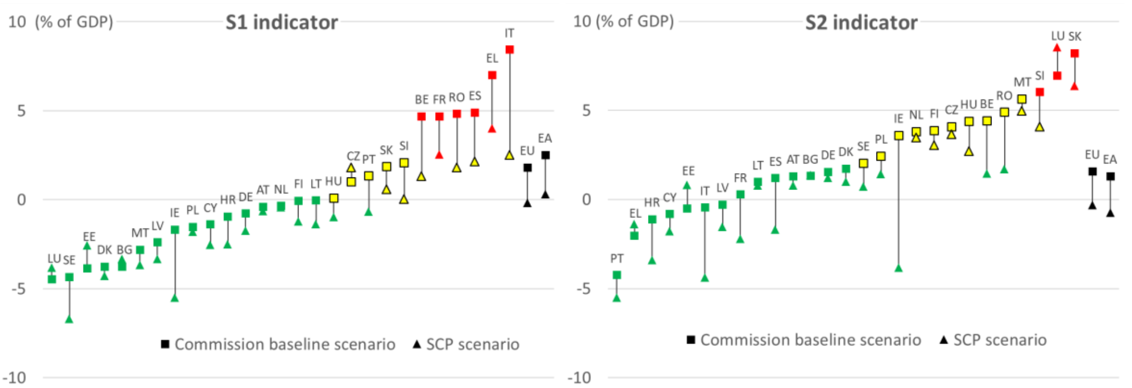
([26]) See https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/spring-2021-economic-forecast_en.

Graph A1.3: **Stochastic debt projections, 2020-2025, euro area**



Note: For more information, see the 2020 Debt Sustainability Monitor.
Source: European Commission

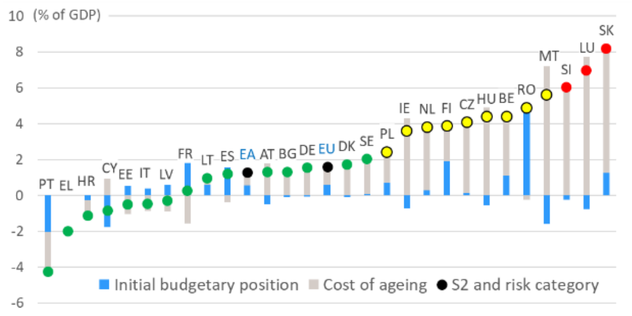
Graph A1.4: **S1and S2 indicators and risk categories based on the Commission baseline scenario and the SCP scenario**



Note: Green: low risk. Yellow: medium risk. Red: high risk. There is no aggregate risk classification for the EU and the euro area. The S1 indicator measures the effort required to bring the debt-to-GDP ratio to 60 % in 15 years. It corresponds to a cumulated improvement in the structural primary balance over 5 years compared with the baseline. The S2 indicator shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon. (See for more information the 2020 Debt Sustainability Monitor).
The Commission baseline scenario assumes a gradual return of structural primary balances to their pre-pandemic (2019) levels. The SCP scenario assumes that the plans presented in the SCPs are fully implemented and that, beyond the programme horizon, structural primary balances revert to their pre-crisis planned values.
Source: European Commission

Several additional factors may affect fiscal sustainability. On the upside, many factors contribute to mitigating debt sustainability risks across the EU. These include the lengthening of debt maturities in recent years, relatively stable financing sources with a diversified and large investor base, and historically low borrowing costs supported by the ECB's interventions. Moreover, the implementation of the reforms and investment under the NGEU/RRF is expected to have a positive and persistent impact on EU growth and thus lower debt-to-GDP ratios in the coming years. However, this impact is not yet fully incorporated in the fiscal sustainability assessment.

Graph A1.5: **Breakdown of the S2 indicator, Commission baseline scenario**



Notes: This graph breaks down the S2 indicator into the initial budgetary position and the long-term budgetary impact of population ageing ("cost of ageing"). The S2 indicator shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon. Green: low risk. Yellow: medium risk. Red: high risk. There is no aggregate risk classification for the EU and the euro area. For Greece, the baseline scenario assumes that the primary balance target of 2.2% of GDP is maintained in the long term, which is supposed to cover the cost of ageing; this cost is therefore not factored in separately. For more information, see the 2020 Debt Sustainability Monitor.
Source: European Commission

On the downside, additional risks could emerge from contingent liabilities stemming from the private sector, including if state guarantees granted to firms and self-employed during the COVID-19 crisis materialise. A reversal in the currently observed low-interest environment over the medium term could also aggravate vulnerabilities in some countries. Finally, the projections are contingent on the phasing out of some temporary measures and the financing of some permanent measures.

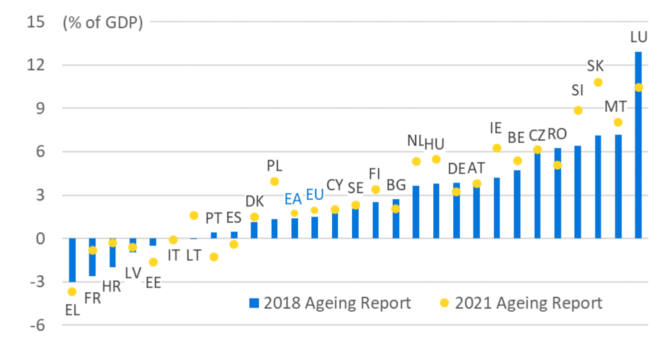
A1.4. LONG-TERM RISKS

Projected age-related costs have increased on aggregate. Compared to the 2018 Ageing Report, the 2021 Ageing Report projects a slightly higher impact of population ageing on public expenditure for the EU as a whole over the long term, yet with heterogeneous changes across countries (Graph A1.6). The higher cost of ageing affects the S2 indicator, which measures the gap with respect to the structural primary balance required to stabilise debt over the long run and cover all the future changes in age-related expenditure. ([27]) In most of the countries with medium or high long-term risks, the sustainability risks are nearly entirely attributable to the projected cost of ageing, with the exception of Romania and to a lesser extent Finland where the initial budgetary position is a large source of vulnerability (Graph A1.5).

Five countries face high long-term risks (Belgium, Luxembourg, Romania, Slovenia and Slovakia). These risks are assessed using both the DSA and the S2 indicator. Among the remaining 22 countries, 17 are assessed at medium risk, often on account of the findings of the DSA (see Table A1.1). Only five countries (Bulgaria, Denmark, Germany, Estonia and Latvia) appear to be at low risk over the long term.

In most countries, fully implementing the SCP plans would alleviate long-term sustainability risks. The overall more benign outlook under the SCP scenario is visible in the lower values it implies for the S2 indicator (Graph A1.4). On this basis, only two countries would face high risks in the long term, while the S2 indicator based on the Commission baseline scenario would identify three countries with high sustainability risk.

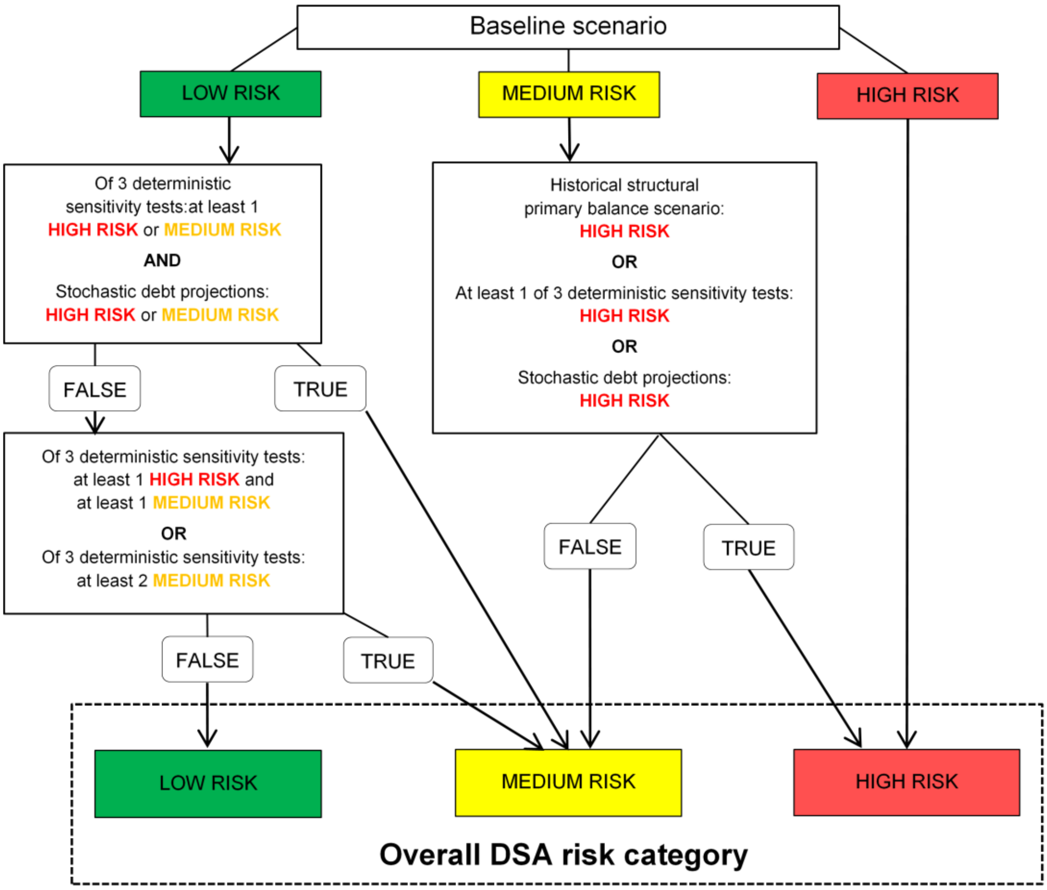
Graph A1.6: **Comparison of the projected change in age-related public expenditure, 2021 Ageing Report vs 2018 Ageing Report**



Note: For more information, see the 2021 Ageing Report.
Source: European Commission

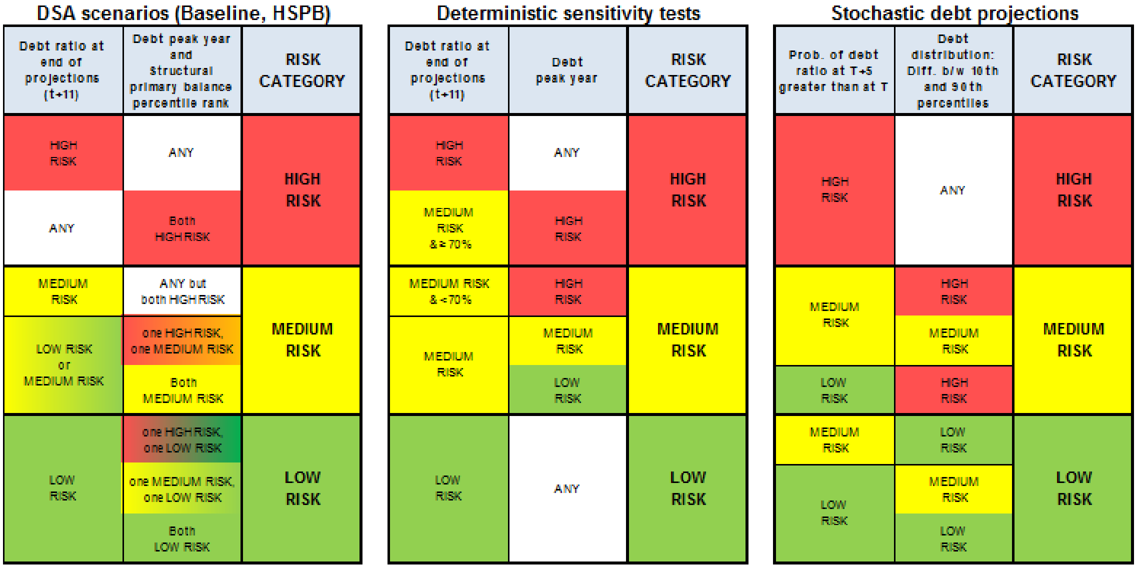
([27]) The (upfront) adjustment to the structural primary balance is anchored to the Commission baseline, and assumed to take place once the structural primary balance has reached its pre-crisis forecast value.

Graph A1.1: **Risk classification in the debt sustainability analysis: decision tree**



Source: European Commission

Graph A1.2: **Risk classification in the debt sustainability analysis: assessment criteria and thresholds**



<table>
<tr><th>Variable</th><th colspan="2">Threshold (% of GDP)</th></tr>
<tr><td>Debt ratio at the end of projections (2031)</td><td colspan="2">Red: above 90%
Yellow: between 60% and 90%
Green: below 60%</td></tr>
<tr><td>Debt peak year</td><td colspan="2">Red: peak year btw. T+7 and end projections (2027-31), or still increasing at end projections
Yellow: peak year between end of forecasts (T+3) and T+6 (2023-26)
Green: peak year within forecast horizon (2020-22)</td></tr>
<tr><td>Percentile rank of average structural primary balance over projection period (2022-31)</td><td colspan="2">Red: if smaller than (or equal to) 15%
Yellow: between 15% and 30%
Green: greater than 30%</td></tr>
<tr><td rowspan="3">Probability of debt ratio at the end of 5-year stochastic projection horizon (2025) greater than initial (2020) debt ratio</td><td>Initial (2019) debt ratio at or above 90%:</td><td>Red: if probability above 30%
Yellow: if probability strictly positive and at or below 30%
Green: if zero probability</td></tr>
<tr><td>Initial (2019) debt ratio at or above 60% and below 90%:</td><td>Red: if probability above 60%
Yellow: if probability between 30% and 60%
Green: if probability below 30%</td></tr>
<tr><td>Initial (2019) debt ratio below 60%:</td><td>Yellow: if probability above 70%
Green: if probability at or below 70%</td></tr>
<tr><td>Difference between 10th and 90th debt distribution percentiles from stochastic projections</td><td colspan="2">Red: the third of the countries with highest dispersion
Yellow: the third of the countries with intermediate dispersion
Green: the third of the countries with lowest dispersion</td></tr>
</table>

Source: European Commission

ANNEX 2
Key macro-fiscal indicators

Table A2.1: **General government debt (%of GDP)**

	2021 Stability and Convergence Programmes				2021 Spring forecast			Difference compared to forecast (red means higher in programme)	
	2021	2022	2023	2024	2020	2021	2022	2021	2022
BE	116.3	116.0	116.7	117.4	114.1	115.3	115.5	0.9	0.4
CY	111.9	103.9	99.5	92.9	118.2	112.2	106.6	-0.3	-2.7
DE	74.5	73.9	73.2	71.9	69.8	73.1	72.2	1.4	1.7
EE	21.4	24.6	27.4	28.0	18.2	21.3	24.0	0.1	0.6
EL	204.8	189.5	176.7	166.1	205.6	208.8	201.5	-4.0	-12.0
IE	62.2	60.2	59.0	57.7	59.5	61.4	59.7	0.8	0.5
ES	119.5	115.1	113.3	112.1	120.0	119.6	116.9	-0.1	-1.8
FR	117.8	116.3	117.2	118.0	115.7	117.4	116.4	0.4	-0.1
IT	159.8	156.3	155.0	152.7	155.8	159.8	156.6	0.0	-0.3
LV	48.9	50.3	48.8	48.5	43.5	47.3	46.4	1.6	3.9
LT	52.1	54.2	57.9	57.9	47.3	51.9	54.1	0.2	0.1
LU	26.9	28.0	28.4	28.2	24.9	27.0	26.8	-0.1	1.2
MT	65.0	65.8	66.0	65.6	54.3	64.7	65.5	0.3	0.3
NL	58.6	56.9	56.0	55.3	54.5	58.0	56.8	0.6	0.1
AT	89.6	88.1	88.1	87.6	83.9	87.2	85.0	2.4	3.1
PT	128.0	123.0	120.7	117.1	133.6	127.2	122.3	0.8	0.7
SI	80.4	79.6	79.0	78.0	80.8	79.0	76.7	1.4	2.9
SK	64.1	65.5	64.6	65.8	60.6	59.5	59.0	4.6	6.5
FI	71.6	72.4	73.9	74.7	69.2	71.0	70.1	0.6	2.3
BG	27.4	28.6	29.3	0.0	25.0	24.5	24.0	2.9	4.6
CZ	44.8	48.2	51.5	54.6	38.1	44.3	47.1	0.4	1.1
DK	40.7	41.3	41.6	41.3	42.2	40.2	38.8	0.5	2.5
HR	86.6	82.5	79.5	76.8	88.7	85.6	82.9	1.0	-0.4
HU	79.9	79.3	77.5	75.7	80.4	78.6	77.1	1.3	2.2
RO	50.8	52.9	53.3	52.4	47.3	49.7	52.7	1.1	0.2
PL	60.0	59.2	58.7	57.9	57.5	57.1	55.1	2.9	4.1
SE	39.9	37.0	33.7	31.4	39.9	40.8	39.4	-0.9	-2.4
EA	103.2	101.3	100.6	99.7	100.0	102.4	100.8	0.8	0.5
EU	95.3	93.6	92.9	91.8	92.4	94.4	92.9	0.9	0.6

Source: European Commission Spring forecast and 2021 SCPs

Table A2.2: **Headline balance (%of GDP)**

	2021 Stability and Convergence Programmes				2021Spring forecast			Difference compared to forecast (red means higher in programme)	
	2021	2022	2023	2024	2020	2021	2022	2021	2022
BE	-7.7	-4.5	-4.0	-3.7	-9.4	-7.6	-4.9	-0.1	0.5
CY	-4.7	-0.9	0.1	1.6	-5.7	-5.1	-2.0	0.3	1.2
DE	-8.9	-3.1	-1.6	-0.6	-4.2	-7.5	-2.5	-1.4	-0.6
EE	-6.0	-3.8	-3.2	-2.2	-4.9	-5.6	-3.3	-0.4	-0.5
EL	-9.9	-2.9	-0.4	0.6	-9.7	-10.0	-3.2	0.1	0.3
IE	-4.7	-2.8	-1.2	-0.7	-5.0	-5.0	-2.9	0.3	0.1
ES	-8.4	-5.0	-4.0	-3.2	-11.0	-7.6	-5.2	-0.9	0.2
FR	-9.0	-5.3	-4.4	-3.9	-9.2	-8.5	-4.7	-0.5	-0.6
IT	-9.5	-5.4	-3.7	-3.4	-9.5	-11.7	-5.8	2.2	0.4
LV	-9.3	-2.7	-1.3	-0.3	-4.5	-7.3	-2.0	-2.0	-0.7
LT	-8.1	-6.0	-4.0	-2.2	-7.4	-8.2	-6.0	0.1	0.0
LU	-2.0	-1.3	-0.4	0.0	-4.1	-0.3	-0.1	-1.7	-1.2
MT	-12.0	-5.6	-3.9	-2.9	-10.1	-11.8	-5.5	-0.2	-0.1
NL	-5.9	-1.7	-1.4	-1.1	-4.3	-5.0	-1.8	-0.9	0.1
AT	-8.4	-4.3	-3.0	-2.5	-8.9	-7.6	-3.0	-0.8	-1.3
PT	-4.5	-3.2	-2.2	-1.6	-5.7	-4.7	-3.4	0.2	0.2
SI	-8.6	-5.7	-3.8	-2.8	-8.4	-8.5	-4.7	-0.1	-1.0
SK	-9.9	-5.1	-4.1	-3.8	-6.2	-6.5	-4.1	-3.4	-1.0
FI	-4.7	-2.9	-2.1	-1.7	-5.4	-4.6	-2.1	-0.1	-0.8
BG	-5.6	-2.7	-3.1	0.0	-3.4	-3.2	-1.9	-2.4	-0.8
CZ	-8.8	-5.9	-5.4	-5.2	-6.2	-8.5	-5.4	-0.3	-0.5
DK	-3.3	-0.9	-0.7	-0.6	-1.1	-2.1	-1.4	-1.2	0.5
HR	-3.8	-2.6	-1.9	-1.5	-7.4	-4.6	-3.2	0.7	0.6
HU	-7.5	-5.9	-3.9	-3.0	-8.1	-6.8	-4.5	-0.7	-1.4
RO	-8.0	-6.2	-4.4	-2.9	-9.2	-8.0	-7.1	0.0	0.9
PL	-6.9	-4.2	-3.2	-2.5	-7.0	-4.3	-2.3	-2.6	-1.9
SE	-4.5	-1.0	0.5	1.0	-3.1	-3.3	-0.5	-1.2	-0.5
EA	-8.3	-4.1	-2.8	-2.2	-7.2	-8.0	-3.8	-0.4	-0.3
EU	-8.0	-4.0	-2.8	-2.1	-6.9	-7.5	-3.7	-0.5	-0.3

Source: European Commission Spring forecast and 2021 SCPs

Table A2.4: **Real GDP growth**

	2021 Stability and Convergence Programmes				2021Spring forecast			Difference compared t forecast (red m higher in programme
	2021	2022	2023	2024	2020	2021	2022	2021
BE	4.1	3.5	1.7	1.5	-6.3	4.5	3.7	-0.4
CY	3.6	3.8	3.2	2.8	-5.1	3.1	3.8	0.5
DE	3.0	2.6	1.2	1.2	-4.9	3.4	4.1	-0.4
EE	2.5	4.8	3.2	3.1	-2.9	2.8	5.0	-0.3
EL	3.6	6.2	4.1	4.4	-8.2	4.1	6.0	-0.5
IE	4.5	5.0	3.5	3.2	3.4	4.6	5.0	-0.1
ES	6.5	7.0	3.5	2.1	-10.8	5.9	6.8	0.7
FR	5.0	4.0	2.3	1.6	-8.1	5.7	4.2	-0.7
IT	4.5	4.8	2.6	1.8	-8.9	4.2	4.4	0.3
LV	3.0	4.5	3.2	2.8	-3.6	3.5	6.0	-0.5
LT	2.6	3.2	3.2	3.2	-0.9	2.9	3.9	-0.3
LU	4.0	4.0	2.7	2.6	-1.3	4.5	3.3	-0.5
MT	3.8	6.8	4.5	4.0	-7.0	4.6	6.1	-0.8
NL	2.2	3.5	1.8	1.4	-3.7	2.3	3.6	-0.1
AT	1.5	4.7	1.6	1.8	-6.6	3.4	4.3	-1.9
PT	4.0	4.9	2.8	2.4	-7.6	3.9	5.1	0.1
SI	4.6	4.4	3.3	3.0	-5.5	4.9	5.1	-0.3
SK	3.3	6.3	2.8	0.3	-4.8	4.8	5.2	-1.5
FI	2.6	2.5	1.5	1.4	-2.8	2.7	2.8	-0.1
BG	2.7	3.6	3.4	2.7	-4.2	3.5	4.7	-0.8
CZ	3.1	3.7	1.9	2.1	-5.6	3.4	4.4	-0.3
DK	2.1	3.8	2.3	1.3	-2.7	2.9	3.5	-0.8
HR	5.2	6.6	4.1	3.4	-8.0	5.0	6.1	0.2
HU	4.3	5.2	4.1	4.0	-5.0	5.0	5.5	-0.7
RO	5.0	4.8	5.0	4.9	-3.9	5.1	4.9	-0.1
PL	3.8	4.3	3.7	3.5	-2.7	4.0	5.4	-0.2
SE	3.2	3.8	1.9	1.6	-2.8	4.4	3.3	-1.2
EA	4.0	4.1	2.1	1.7	-6.6	4.3	4.4	-0.3
EU	3.9	4.1	2.3	1.8	-6.1	4.2	4.4	-0.3

Source: European Commission Spring forecast and 2021 SCPs

Table A2.3: **Real GDP growth, 2019-2022 (index, 2019=100)**

	2021Spring forecast			
	2019	2020	2021	2022
BE	100	93.7	98.0	101.6
CY	100	94.9	97.9	101.6
DE	100	95.1	98.3	102.3
EE	100	97.1	99.8	104.8
EL	100	91.8	95.5	101.2
IE	100	103.4	108.2	113.6
ES	100	89.2	94.4	100.8
FR	100	91.9	97.1	101.2
IT	100	91.1	95.0	99.1
LV	100	96.4	99.7	105.7
LT	100	99.1	102.0	106.0
LU	100	98.7	103.1	106.5
MT	100	93.0	97.3	103.2
NL	100	96.3	98.5	102.0
AT	100	93.4	96.6	100.7
PT	100	92.4	96.1	101.0
SI	100	94.5	99.1	104.1
SK	100	95.2	99.8	105.1
FI	100	97.2	99.9	102.6
BG	100	95.8	99.2	103.9
CZ	100	94.4	97.6	101.9
DK	100	97.3	100.1	103.6
HR	100	92.0	96.6	102.4
HU	100	95.0	99.8	105.3
RO	100	96.1	101.0	105.9
PL	100	97.3	101.2	106.7
SE	100	97.2	101.5	104.8
EA	100	93.4	97.4	101.7
EU	100	93.9	97.8	102.2

Source: European Commission Spring forecast and 2021 SCPs

Glossary

Automatic stabilisers Features of the government budget that react automatically – without policy change – to the economic cycle and reduce its fluctuations. For example, unemployment benefits tend to increase and tax revenues tend to decrease during an economic downturn. As a result of the operation of automatic stabilisers, the headline budget balance as a share of GDP tends to increase during economic upturns and decrease during economic downturns.

Bottom-up fiscal effort A quantification of the overall impact of discretionary fiscal measures on the general government balance obtained by summing the budgetary costs of individual measures.

Budget balance The balance of total public revenue and expenditure and in a specific year (often referred to as the *headline balance)*. A positive balance indicates a *surplus* and a negative balance indicates a *deficit*.

Change in fiscal position A change in the underlying fiscal position of the government (without the impact of automatic stabilisers). The *expenditure benchmark* is the main indicator used to measure the change in fiscal position under the *Stability and Growth Pact*. In the current context, this indicator needs to take into account specific circumstances related to the COVID-19 crisis and the ensuing recovery. In particular, it needs to take into account the phasing-out of *temporary emergency measures*. Moreover, the need for fiscal policy to remain prudent while being conducive to a sustainable recovery justifies a focus on developments in nationally-financed *primary current expenditure* (net of discretionary revenue measures and excluding *one-offs measures*), as opposed to *public investment*. In this note, the change in national budgetary position is therefore calculated as follows:

$$Change\ in\ fiscal\ position_t = \frac{(1+Pot_t)*(1+\pi_t)*E_{t-1}^{FA} - E_t^{FA} + \Delta RM_t}{Y_t}$$

where *Pot* indicates the 10-year average potential growth; π is inflation measured by the GDP deflator; ΔRM_tstands for the incremental budgetary impact of permanent discretionary revenue measures (excluding temporary emergency measures) and E_t^{FA} is the expenditure aggregate computed as follows:

$$E_t^{FA} = G_t - I_t - U_t - EU\ current\ expenditure_t - Capital\ expenditure_t - \ one_{offs}{}_t^{currentG} - emerg.measures_t^{currentG}$$

where G_t is general government total expenditure; U_t the cost of (cyclical) unemployment benefits; I_t is interest expenditure; $EU\ current\ expenditure_t$ is current expenditure financed by the EU budget (RRF and other funds); $Capital\ expenditure_t$ is all capital expenditure financed by both the national and EU budgets; Y_t is nominal GDP.

Code of Conduct A policy document that sets out agreed guidelines for the implementation of the *Stability and Growth Pact*, including on the format and content of the *stability and convergence programmes*.

Convergence programmes Medium-term budgetary strategies and monetary policy objectives of Member States that have not yet adopted the euro. The programmes are updated annually, according to the provisions of the preventive arm of the *Stability and Growth Pact* (Council Regulation (EC) 1466/97).

Discretionary fiscal policy The change in the budget balance and its components related to new fiscal measures adopted by the government (as opposed to the operation of automatic stabilisers).

Expenditure benchmark An indicator of the *Stability and Growth Pact* that measures budgetary developments by comparing the growth of general government primary expenditure (net of discretionary revenue measures, excluding one-offs and cyclical unemployment expenditure) to the 10-year average potential growth rate. For nationally-financed gross fixed capital formation, the 4-year average is used instead of the annual figure.

Fiscal stance (or fiscal impulse) A measure of the short-term impact of discretionary fiscal policy on the economy. In the current context, this measure includes support from the EU budget (in particular *NGEU* and its *RRF)*. In this note, the fiscal stance is therefore defined as follows:

$$Fiscal\ stance\ including\ EU\ budget_t = \frac{(1 + Pot_t) * (1 + \pi_t) * E_{t-1}^{FS} - E_t^{FS} + \Delta RM_t}{Y_t}$$

where *Pot* indicates the 10-year average potential growth; π is inflation measured by the GDP deflator; ΔRM_t stands for the incremental budgetary impact of permanent discretionary revenue measures and E_t^{FS} is the expenditure aggregate computed as follows:

$$E_t^{FS} = G_t - I_t - U_t - \ {one_{offs}}_t^G - emerg.measures_t^G$$

where G_t is general government total expenditure, including new expenditures financed by RRF grants; U_t the cost of (cyclical) unemployment benefits; I_t is interest expenditure; Y_t is nominal GDP. This expenditure aggregate differentiates from the one used in the *expenditure benchmark* as expenditure financed by the EU budget is included and there is no smoothing of gross fixed capital formation (i.e. annual gross fixed capital formation data are used instead of the 4-year average), while temporary emergency measures are excluded. Contributions from national budgets to the EU budget are not considered here, as they are rather stable over time and across Member States.

Fiscal space The leeway available to the government to run an expansionary fiscal policy. While this concept can be difficult to quantify and several methods are possible to measure it, it broadly reflects country-specific debt sustainability challenges and financial market conditions.

General escape clause A provision of the *Stability and Growth Pact* that allows for a coordinated and orderly temporary deviation from the normal fiscal adjustment requirements for all Member States during a severe economic downturn in the euro area or the EU as a whole. It could apply to the preventive and corrective arms of the *Stability and Growth Pact*.

Independent fiscal institutions Independent public bodies, other than central banks, that prepare macroeconomic and budgetary forecasts, monitor fiscal performance and advise the government on fiscal policy issues.

Medium term budgetary objective A country-specific value of the *structural budget balance* to be achieved in the medium term, according to the preventive arm of the Stability and Growth Pact

Modified domestic demand A measure of Irish domestic activity that strips out some effects of multinationals headquartered in Ireland. This measure is considered a more useful indicator of domestic economic conditions in Ireland than GDP.

Modified gross national income (GNI*) A measure of Irish national income that excludes the depreciation of foreign-owned capital assets (notably intellectual property and assets associated with aircraft leasing) and undistributed profits of firms that have re-domiciled to Ireland.

NextGenerationEU (NGEU) A €750 billion temporary recovery instrument adopted at EU level to help repair the immediate economic and social damage brought about by the COVID-19 pandemic, and to support a sustained and sustainable recovery.

One-off measures Government transactions that have a transitory budgetary effect and do not lead to a permanent change in the budget balance.

Output gap The difference between actual output and estimated potential output at any particular point in time.

Policy mix The overall stance of fiscal and monetary policy taken together. The policy mix consists of various combinations of expansionary and restrictive policies.

Potential GDP The level of GDP in a given year that is consistent with a stable rate of inflation. If GDP rises above its potential level, then supply constraints can become binding and inflationary pressures build. If, in contrast, output falls below potential, resources lie idle and inflationary pressures abate. In the context of the *Stability and Growth Pact*, potential GDP is computed according to a methodology based on a production function that has been commonly agreed at EU level.

Primary budget balance The budget balance net of interest expenditure on general government debt.

Primary current expenditure Government spending on goods and services for current use, net of interest expenditure. It excludes capital expenditure (which itself encompasses *public investment*).

Public debt Consolidated gross debt of the general government. It includes the total nominal value of all debt owed by public institutions in the Member State, except trade debt.

Public investment The component of public expenditure through which the government increases and improves the stock of tangible and intangible public capital. In this note, public investment is synonymous with gross fixed capital formation.

Recovery and Resilience Facility (RRF) The largest instrument included in *NextGenerationEU*. The RRF will make €672.5 billion in loans (€360 billion) and grants (€312.5 billion) available to support reforms and investments undertaken by Member States.

Resilience and Recovery Plans (RRPs) Medium-term plans that set out Member States' reform and public investment strategies to be supported by the *RRF*.

Recovery support measures Fiscal measures introduced since March 2020 to ensure a sustainable recovery following the COVID-19 pandemic. These measures can be either temporary or permanent; some may be funded by *RRF* grants. When these measures affect the budgetary balance beyond 2022, they are considered to be permanent.

Snowball effect The net impact of interest rates, inflation, and real GDP growth (that is, the interest rate-growth differential) on debt dynamics.

Sovereign bond spread The difference between the yield on a sovereign bond and a risk-free benchmark. In the euro area, the benchmark is typically the yield on a German sovereign bond of the same maturity.

Stability and Growth Pact A set of rules designed to ensure that European Union Member States pursue sound public finances and coordinate their fiscal policies. These rules are set out in both primary and secondary EU legislation. Their operation is thoroughly described in the *Vade Mecum on the Stability and Growth Pact*.

Stability programmes Medium-term budgetary strategies presented by euro area Member States. The programmes are updated annually, according to the provisions of the preventive arm of the *Stability and Growth Pact* (Council Regulation (EC) 1466/97).

Stock-flow adjustment Difference between the annual change in the level of public debt (expressed in national currency) and the budget deficit. This difference is due to changes in financial assets, changes in the value of debt denominated in foreign currency and other statistical effects.

Structural budget balance The headline budget balance net of the cyclical component (i.e. *automatic stabilisers*) and *one-off measures*. The structural balance is one of the measures of the budgetary position used in the *Stability and Growth Pact*.

Temporary emergency measures Fiscal measures introduced since March 2020 to support health systems and compensate workers and firms for pandemic-induced income losses. These measures are designed to keep the economy afloat and limit economic scarring. They are by nature temporary, with an expiry date in 2023 or earlier, consistent with the expected normalisation of the public health and economic situation. Despite being temporary, they are not considered *one-offs* under the EU fiscal framework due to their multi-annual nature. In this note, measures with a budgetary impact in 2023 that is below 10% of the initial budgetary impact are considered temporary.

Top-down fiscal effort A quantification of the impact of government fiscal policy actions obtained by looking at the change in a *budgetary aggregate*, typically the structural balance. This may differ from a bottom-up measure due to the incomplete coverage of the latter, second-order economic effects or different assumptions about developments at unchanged policies (i.e. trends affecting the costing of existing measures).

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