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The 2022 Stability & Convergence Programmes

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

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EXECUTIVE SUMMARY

The EU economy underwent a robust recovery in 2021 as a result of coordinated policy action. The EU economy has been more resilient to the COVID-19 crisis than originally expected due to the strong policy response at both the national and the EU level. The general escape clause of the Stability and Growth Pact coupled with the State aid temporary framework enabled large-scale fiscal support in all Member States. In parallel, the EU mobilised its budget, in particular with SURE to mitigate the impact of the crisis on workers and companies. The roll-out of NextGeneration EU, including the RRF, is providing a strong impetus to the recovery. As a result, EU real GDP grew by 5.4% in 2021 after contracting by 5.9% in 2020. Fuelled by the favourable macroeconomic environment, the EU headline deficit fell from 6.8% of GDP in 2020 to 4.7% of GDP in 2021. The aggregate debt ratio decreased to around 90% in 2021 from the historically high level of around 92% a year earlier, having benefitted from the acceleration in growth and inflation.

The 2022 Stability and Convergence Programmes (SCPs) and the Commission 2022 spring forecast both point to a further improvement in public finances in 2022 and 2023, whilst the war in Ukraine poses new macro-economic challenges. The invasion of Ukraine by Russia has changed the economic outlook by bringing renewed disruptions in global supply, fuelling further commodity price pressures and heightening uncertainty for firms and households. Notwithstanding those developments, the EU economy is projected to continue its recovery in 2022 and 2023, but at a more subdued pace than in 2021. Public finances are expected to improve in both years. The improvement in 2022 reflects the ongoing economic recovery and the reduced impact of COVID-19 temporary emergency measures, while new measures to support households and firms to cope with the high energy prices and the costs to provide assistance to displaced persons from the war in Ukraine will weigh on public finances. For 2023 the further decline projected in deficits is due to the continuing recovery and the phasing out of the temporary measures put in place during the pandemic and to mitigate the impact of the high energy prices. Debt ratios are projected to decrease over the programme horizon in most Member States due to the favourable interest rate-growth differential, including on the back of high inflation.

Heightened uncertainty and strong downside risks to the economic outlook in the context of war in Europe, unprecedented energy price hikes and continued supply chain disturbances warrant the extension of the general escape clause of the Stability and Growth Pact through 2023. In the context of the war in Europe, unprecedented energy price hikes and continued supply chain disturbances, the state of the EU and euro area economy has not returned to more normal conditions. Moreover, the decision on the continued application or deactivation of the general escape clause should also consider the need for fiscal policy to be able to respond appropriately to the economic repercussions of Russia’s military aggression against Ukraine including from energy supply disruptions. The continued activation of the general escape clause will provide the space for national fiscal policy to react promptly when needed, while ensuring a smooth transition from the broad-based support to the economy during the pandemic times towards an increasing focus on temporary and targeted measures and fiscal prudence required to ensure medium-term sustainability. The Commission considers that the conditions to maintain the general escape clause in 2023 and to deactivate it as of 2024 are met.

COVID-19 temporary emergency measures are increasingly replaced by measures to support the recovery. COVID-19-related emergency measures are set to provide fiscal support in 2022 – albeit significantly less than in 2021 (they represent 0.8% of EU aggregate GDP in 2022 compared with 3.2% of GDP in 2021) – before being phased out completely in 2023. The rising cost of recovery support measures would be funded mostly from the national budgets in 2022 and 2023. Meanwhile, Member States would accelerate the absorption of Recovery and Resilience Facility (RRF) grants and channel them towards public investment to a significant extent. Measures related to the increase in energy prices are set to increase in 2022, but are currently planned to be nearly completely withdrawn in 2023. In 2024-2025, the SCPs plan prudent fiscal policies in most Member States, with an increase in net current primary expenditure below medium-term potential growth.

The share of public investment in GDP will grow in 2022-2023, with around a quarter of the increase being financed by the EU budget, mainly through the RRF. High quality public investment is needed to boost growth potential, ensure a sustainable and inclusive recovery and meet the substantial investment needs for the green and digital transition. Almost all Member States are expected to spend more on public investment than they did before the pandemic. Until 2026 EU instruments such as the RRF will substantially help to address the sizeable investment needs facing Europe. The reforms and investments proposed by Member States in their RRPs are focused, to a significant extent, on meeting the climate and digital transition objectives. Moreover, the RRF supports the coordinated planning and financing of cross-border and national infrastructure, as well as energy projects and reforms. RepowerEU will also help Member States in achieving energy independence from Russian fossil fuels as soon as possible.

The fiscal stance for the euro area as a whole is set to remain supportive in 2022. Including the fiscal impulse provided at the EU level through the RRF and other funds, while excluding COVID-19 temporary emergency measures, the fiscal stance is set to provide additional support to aggregate demand in the euro area – of around 1¾% of GDP – in 2022. The supportive fiscal stance reflects the sizeable increases in nationally financed net current expenditure. The latter includes new measures to help vulnerable households and firms cope with the surge in energy prices (more than ½% of GDP) and the humanitarian assistance to displaced persons from Russia's war on Ukraine (0.1% of GDP). Public investment spending financed by both the national budgets and by RRF grants and other EU funds is set to add to the fiscal expansion in 2022. In addition, other elements that have not been matched by corresponding compensatory measures are also contributing to the expansionary fiscal stance this year.

In 2023 the euro area fiscal stance would be slightly contractionary (by around ½% of GDP) due to the announced phasing out of the measures to mitigate the impact of energy price hikes. The euro area fiscal stance is slightly contractionary under a no policy change assumption in 2023. Fiscal policy should be prudent in 2023, while standing ready to react to the evolving economic situation. The specific nature of the macroeconomic shock imparted by Russia's invasion of Ukraine, as well as its long-term implications for the EU's energy security needs, call for a careful design of fiscal policy in 2023. Fiscal policy should combine higher investment with controlling the growth in nationally-financed primary current expenditure, while allowing automatic stabilisers to operate and providing temporary and targeted measures to mitigate the impact of the energy crisis and to provide humanitarian assistance to people fleeing from Russia's invasion of Ukraine. The expected further increase in RRF absorption and in nationally-financed investment across Member States appears to be consistent with the need to expand public investment for the green and digital transition and for energy security, including by making use of the RRF and other EU funds. At the same time, fiscal policy needs to remain agile given the uncertainty following the war in Ukraine, while reflecting the need to avoid amplifying the inflationary effects of ongoing supply and demand shocks. Beyond 2023, all Member States should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions. Moreover, high-debt Member States should ensure credible and gradual debt reduction and fiscal sustainability in the medium-term through progressive consolidation, investment and reforms.

The overall fiscal stance (i.e. the aggregate impulse from both national budgets and the EU budget) is expected to remain supportive in almost all EU Member States in 2022 and become slightly contractionary in 2023 while being investment-rich. In most EU Member States, net primary current public expenditure is set to provide a sizeable expansionary contribution to the fiscal stance in 2022, followed by some consolidation in 2023 mainly related to the projected phasing-out of the energy-related measures. In high-debt Member States, except for Greece, the projected growth in nationally financed current expenditure provides a broadly neutral or contractionary contribution to the overall fiscal stance, relying on the phasing out of the measures to address the impact of the increase in energy prices as currently planned. Only Greece is projected to have a clearly contractionary contribution to the fiscal stance from net primary current expenditure, after considering the phasing out of the temporary measures to mitigate the impact of high energy prices taken in 2022. Almost all Member States are also expected to spend a larger amount of their national budgets on public investment than they did before the pandemic. RRF grants are projected to finance around a quarter of the increase in the share of public investment in GDP in 2022 and 2023. Differences between Member States will depend on the allocation of RRF grants relative to GDP and the degree of absorption of those grants.

While short-term fiscal sustainability challenges have substantially subsided compared with last year, the Commission's latest debt sustainability analysis finds that seven Member States still face high fiscal sustainability risks in the medium term, while nine others face medium risks. Medium-term fiscal sustainability challenges largely reflect the significant deterioration of structural budgetary positions due to the needed fiscal support, which added to existing pre-crisis debt vulnerabilities in several countries, compounded by the uncertainty surrounding baseline projections and possible exposure to adverse shocks. In some countries, the high initial debt ratios are projected to stabilise or decline somewhat only until the mid-2020s. In most countries facing medium- and high sustainability risks, fully implementing the plans presented in the 2022 Stability and Convergence Programmes would strengthen the debt reduction and alleviate sustainability risks. Reforms and investments under NextGeneration EU are expected to mitigate sustainability risks by strengthening future growth potential.

0. INTRODUCTION

This overview note of the 2022 Stability and Convergence Programmes (SCPs) ([1]) provides an aggregate picture of budgetary policy at EU level building on the cross-country assessment of the SCPs, including an assessment of the fiscal stance and policy mix in the euro area.

Close coordination of fiscal policies remains key in the face of renewed macro-economic challenges posed by Russia's war of aggression against Ukraine. Despite entering the third year of the COVID-19 pandemic, the outlook for the EU economy at the beginning of 2022 was for a prolonged and robust expansion. The pandemic situation was improving, while most of the headwinds posed by logistic and supply bottlenecks and pressures on the price of energy and other commodities were expected to fade in the course of this year. The war in Ukraine has dramatically changed this picture for the EU since the end of February, by bringing renewed disruptions in global supply, fuelling further commodity price pressures and heightening uncertainty. Within this context, the continued strong coordination of fiscal policies remains key to ensure a smooth transition towards a new and sustained path for economic growth and fiscal sustainability.

The Commission set out the key principles that would guide its assessment of the 2022 SCPs. On 2 March 2022, the Commission issued a Communication providing Member States with guidance on the conduct of fiscal policy in 2023 based on the Commission winter forecast. The key principles put forward in the Communication are the following: (i) ensure policy coordination and a consistent policy mix; (ii) ensure debt sustainability through a gradual and high-quality fiscal adjustment and economic growth; (iii) foster investment and promote sustainable growth; (iv) promote fiscal strategies consistent with a medium-term approach to fiscal adjustment, taking into account the RRF; (v) differentiate fiscal strategies and take into account the euro area dimension.

The guidance for the conduct of fiscal policy in 2023 was updated following Russia's invasion of Ukraine as part of the European Semester Spring Package. The Commission considered that the conditions were met to maintain the general escape clause of the Stability and Growth Pact (SGP) activated in 2023 and to deactivate it as of 2024. Hence, fiscal policy guidance for 2023 is qualitative, with a quantitative underpinning, with all Member States invited to expand public investment for the green and digital transition and energy security. Full and timely implementation of the RRPs is considered key to achieving higher levels of investment. Prudence in fiscal policy should be reflected in combining higher investment with controlling the growth in nationally-financed primary current expenditure, while allowing automatic stabilisers to operate and providing temporary and targeted measures to mitigate the impact of the energy crisis and to provide humanitarian assistance to people fleeing from Russia's invasion of Ukraine. Moreover, Member States' fiscal plans for next year and beyond should be anchored by prudent medium-term adjustment paths reflecting fiscal sustainability challenges associated with high debt-to-GDP levels that have increased further due to the pandemic. Fiscal policy should also stand ready to adjust current spending to the evolving situation. Finally, the Commission announced that it would provide orientations on possible changes to the economic governance framework after the summer break and well in time for 2023.

The Country Specific Recommendations (CSRs) adopted by the Council on 18 June 2021 served as a basis for the assessment of Member States' SCPs. The recommendations focused on the overall direction and composition of the fiscal stance, including expenditure funded by the RRF and other EU funds. In particular, COVID-19 temporary emergency measures were excluded from the fiscal stance. The Council recommended that Member States with low/medium debt-to-GDP ratios pursue or maintain

([1]) The Stability and Convergence Programmes are a cornerstone of the EU's multilateral fiscal policy coordination. 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 (SGP). The Commission assesses the individual programmes and evaluates the aggregate trends. This note presents the aggregate assessment and is based on data up to 30 April 2022.

a supportive fiscal stance, while Member States with high debt-to-GDP ratios should use the RRF to finance additional investment in support of the recovery, while pursuing a prudent fiscal policy. All Member States were recommended to preserve nationally-financed investment. With a view to maximising support to the recovery without pre-empting future fiscal trajectories and creating a permanent burden on public finances, the growth of nationally-financed current expenditure should be kept under control, and be limited for Member States with high debt-to-GDP ratios. The proposed recommendations for 2023 follow the same logic as the ones for 2022, which were adopted on 18 June 2021.

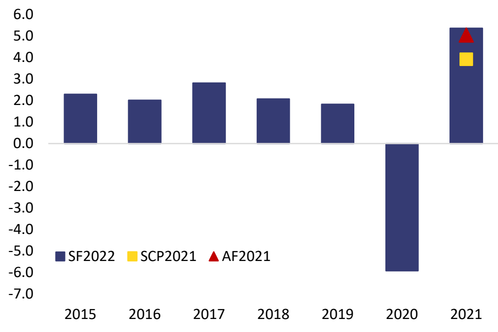
Almost all EU Member States submitted their 2022 SCPs to the Commission by the deadline of April 30, as required by the Council Regulation (EC) No 1466/97. France did not submit its Stability Programme. The plans were produced some time before the publication of the Commission 2022 spring forecast and did not typically take into account the economic and fiscal impact of Russia's war against Ukraine.

This paper consists of three sections, five boxes and two annexes. Section 1 examines the budgetary developments in 2021, which are put into the context of the existing macroeconomic environment. Section 2 focuses on the budgetary plans set out by Member States in their SCPs in 2022 and beyond, including the country-specific fiscal stances. Section 3 looks at the euro area as a whole and assesses the aggregate fiscal stance and the policy mix. The boxes focus on the independent assessment of forecasts underpinning the 2022 SCPs, the measures to mitigate the impact of energy prices on households and firms and their budgetary cost, the fiscal cost for Member States of hosting persons fleeing the war in Ukraine, investment needs and developments and the fiscal policy response to economic shocks. Annex 1 examines the longer-term fiscal sustainability implications of the plans through the lenses of the debt sustainability analysis, while annex 2 presents key macro-fiscal indicators available from the SCPs and the Commission 2022 spring forecast.

1. BUDGETARY DEVELOPMENTS IN 2021

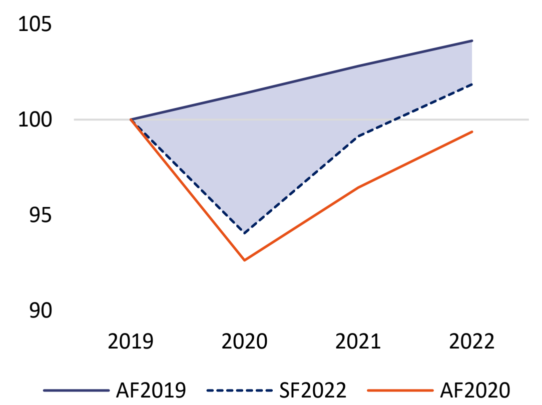
The EU economy underwent a robust recovery in 2021 as a result of coordinated policy action. The general escape clause of the Stability and Growth Pact coupled with the State aid temporary framework enabled large-scale fiscal support in all Member States. In parallel, the EU mobilised its budget, in particular with SURE to mitigate the impact of the crisis on workers and companies. The roll-out of NextGeneration EU, including the RRF, is providing a strong impetus to the recovery. As a result, real GDP grew by 5.4% in 2021 after contracting by 5.9% in 2020. Both domestic demand and the external sector contributed to the recovery. Private consumption grew by 3.8% in 2021 following an increase in household disposable income and some decline in savings rates from the historically high levels recorded in 2020. Private investment increased by 4.2% in 2021 due to favourable financing conditions for the corporate sector, the RRF impulse and strong activity in the construction sector. The rapid acceleration in exports, which outpaced the acceleration in imports, boosted economic activity even more. The EU economy performed better in 2021 than expected in the Commission 2021 autumn forecast, where growth had been projected at 5%, as well as in the 2021 vintage of the SCPs where real GDP growth was projected at 3.9% (Graph 1.1).

Graph 1.1: **EU: Real GDP growth 2015-2021**



Source: European Commission 2021 autumn forecast, 2022 spring forecast and 2022 Stability and Convergence Programmes.

Graph 1.2: **EU: Output losses, 2020-2022 (index, 2019=100)**

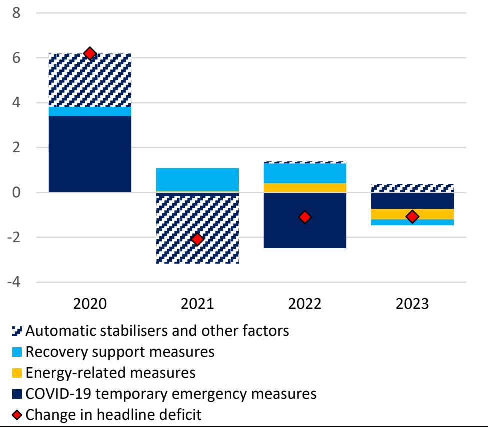


Note: The shaded area denotes the gap between the pre-pandemic forecast and the latest forecast.

Source: European Commission 2019 autumn, 2020 autumn and 2022 spring forecasts.

While the EU economy has been more resilient to the COVID-19 pandemic than originally expected, it has suffered a large cumulated output loss. The contraction in economic activity in 2020, while unprecedented (-5.9 %) was less severe (by 1.5 pp.) than had been expected in the Commission 2020 autumn forecast, and the recovery in 2021 was stronger (by 2.7 pp.). On aggregate, the EU economy returned back to its pre-pandemic output level in the third quarter of 2021, but it remains below the trend that had been projected in the Commission's pre-pandemic forecast of autumn 2019. The cumulated output loss for the EU economy relative to pre-crisis trend, as a result of the COVID-19 pandemic as well as the invasion of Ukraine by Russia, is projected at more than 13% for the 2020-2022 period (the shaded area in Graph 1.2).

Graph 1.3: **Drivers of annual changes in the EU headline deficit: 2020-2023 (% of GDP)**

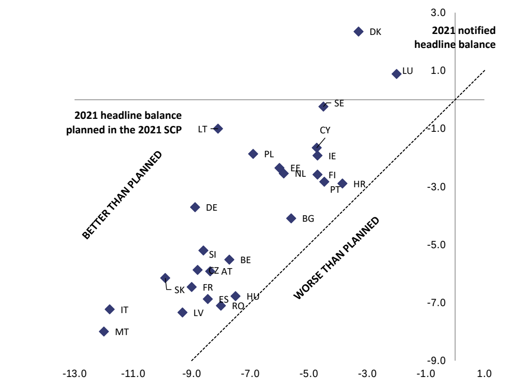


Source: European Commission 2022 spring forecast.

Public deficits declined substantially in 2021 fuelled by the favourable macroeconomic environment. The strong recovery in 2021 and its composition implied a strong increase in revenues, including revenue windfalls ([2]) of around ¾ % of GDP at aggregate EU level that were powered by the growth of the consumption of goods, investment and imports, components that are generally related to sources of income that are more tax rich than services. Together with the working of automatic stabilisers, which provided less support than in 2020 as a result of the acceleration in economic activity, this led to a larger increase in budget revenue compared to spending. Spending developments were also impacted by the introduction of recovery support measures, whereas temporary emergency measures related to the COVID-19 pandemic weighed on the EU aggregate deficit to a similar extent as in 2020 (Table A2.4 and Graph 1.3).

Headline deficits in 2021 turned out considerably lower than planned in line with the stronger than-expected performance of the EU economy. The aggregate headline deficit in the EU fell significantly to 4.7% of GDP in 2021 from 6.8% of GDP in 2020. This deficit outturn was markedly lower than planned in the 2021 vintage of the SCPs, which had projected a further deterioration in the EU aggregate deficit to 8% of GDP in 2021. Budget balance outturns in 2021 were better-than-planned in the 2021 vintage of the SCPs in all Member States. The 2021 budget balance target was over-performed by at least 4 pps of GDP in 7 Member States (Denmark, Germany, Italy, Lithuania, Malta, Poland and Sweden). The over-performance with respect to the target was 1 pp or less in the case of Croatia, Hungary and Romania. The other Member States fell somewhere in between (Graph 1.4). The number of EU Member States with deficits above the 3% of GDP Treaty reference value fell from 25 in 2020 to 15 in 2021. Croatia, Cyprus, Lithuania, Luxembourg and Poland had the strongest decrease in the deficit in 2021 compared to 2020. In contrast, the deficit increased in the case of Latvia and Slovakia, while it remained stable in Bulgaria and Czechia.

Graph 1.4: **Headline balance in EU Member States in 2021, outturn vs 2021 SCPs (% of GDP)**

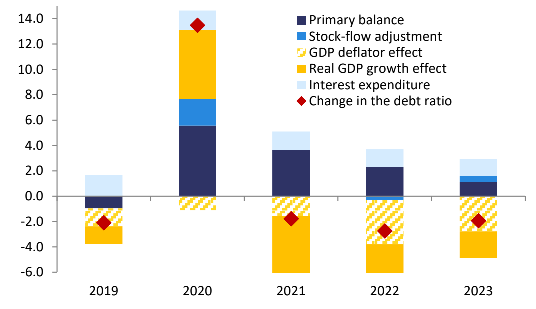


Note: The graph plots the notified/validated 2021 headline budget balances (vertical axis) against the planned headline budget balance (horizontal axis). Member States above (below) the 45-degree line are those where the 2021 outcome was better (worse) than planned.

Source: European Commission and 2021 SCPs.

([2]) Revenue windfalls (shortfalls) are computed by comparing the actual change in government revenues in a given year with the hypothetical change based on nominal GDP growth in that year, assuming unit elasticity, the impact of discretionary revenue measures and the change in revenues from the EU budget.

Graph 1.5: **EU decomposition of the change in the debt ratio 2019-2023 (pps of GDP)**



Source: European Commission 2022 spring forecast.

Public debt dynamics benefitted from the acceleration in growth and inflation. The EU aggregate public debt ratio fell to around 90% in 2021, after having reached the historical high of around 92% in 2020. The reversal of debt dynamics was driven by the strong acceleration in real GDP growth, as well as by the GDP deflator effect following an acceleration in inflation. In contrast, the primary balance continued to have a debt-increasing impact on debt dynamics, albeit to a lesser extent than in 2020, while the impact from interest expenditure in 2021 remained similar to the one in 2020 (Graph 1.5). Among Member States, 14 had a debt-to-GDP ratio above the 60% reference value in 2021, up slightly from 13 Member States in 2020, with 7 Member States (Belgium, Greece, Spain, France, Italy, Cyprus and Portugal) having a debt-to-GDP ratio above 100% of GDP. In Ireland, the debt-to-GDP ratio stood below 60% in 2021, but the debt-to-modified gross national income ratio ([3]) - a more accurate measure of repayment capacity in Ireland- was around 100%. The debt-to-GDP ratio fell by more than 7 pp in 4 Member States (Croatia, Cyprus, Greece and Portugal), while it did not decrease in 7 Member States (Germany, Latvia, Malta, Slovakia, Bulgaria, Czechia, Romania). The public debt-to-GDP ratio turned out lower than predicted in the 2021 vintage of the SCPs, where it was projected at 95%.

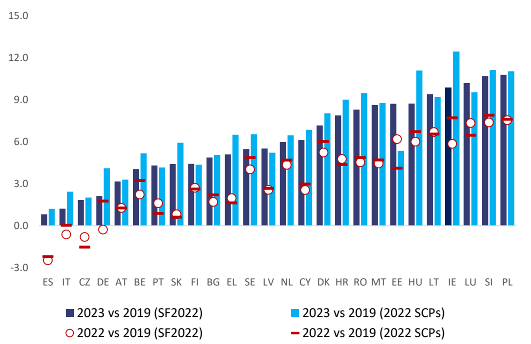
([3]) Modified gross national income (GNI*) reflects income standards of Irish residents more accurately than GDP. This measure excludes the depreciation of foreign-owned capital assets (notably intellectual property and assets associated with aircraft leasing) and undistributed profits of firms that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

2. BUDGETARY PLANS FOR 2022 AND 2023

2.1. MACROECONOMIC AND BUDGETARY OUTLOOK

The EU economy is projected to continue its recovery in 2022 and 2023, albeit at a more subdued pace than in 2021. The Commission 2022 spring forecast and the SCPs both expect a deceleration of growth in 2022, but the Commission growth forecast is notably lower, with real GDP projected to grow by 2.7% compared to 3.5% in the SCPs (Table A2.3 in Annex). This difference is linked to the deterioration in the economic circumstances in the weeks between the preparation of the SCPs and the forecast, as most SCPs do not include the economic and fiscal impact of Russia's war on Ukraine. According to the Commission forecast, with the exceptions of Czechia, Germany, Spain and Italy, all Member States are set to exceed their 2019 annual GDP level by 2022 (Graph 2.1). (4) By 2023, all Member States are expected to surpass their pre-pandemic 2019 annual GDP level, but with significant differences between Member States (Graph 2.1). In general, the Commission forecast expects a weaker recovery than the SCPs by 2023, with the biggest differences in the case of Spain, Greece, Croatia and Slovakia. The fact that the balance of risks surrounding the Commission forecast is heavily skewed towards more adverse outcomes means that GDP growth may turn out lower than forecast, making these SCP projections appear even more optimistic. Most SCPs' macroeconomic projections were prepared or endorsed by independent fiscal institutions (IFIs). In Portugal the IFI was not in a position to issue an endorsement (Box 2.1).

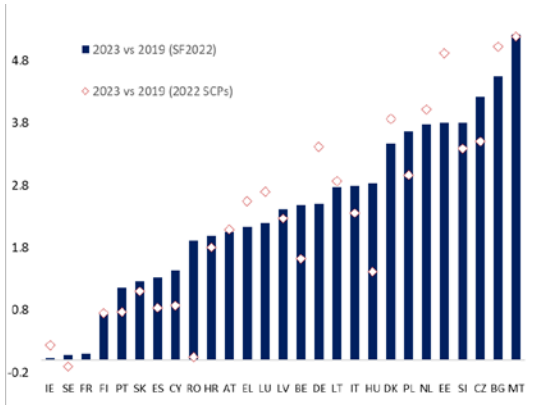
Graph 2.1: **Change in real GDP level in 2022 and 2023 compared to 2019 (% of 2019 real GDP)**



Note: For Ireland, the chart reflects 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.

Source: European Commission 2022 spring forecast and the 2022 SCPs.

Graph 2.2: **Change in headline deficits in 2023 compared to 2019 (pps. of GDP)**



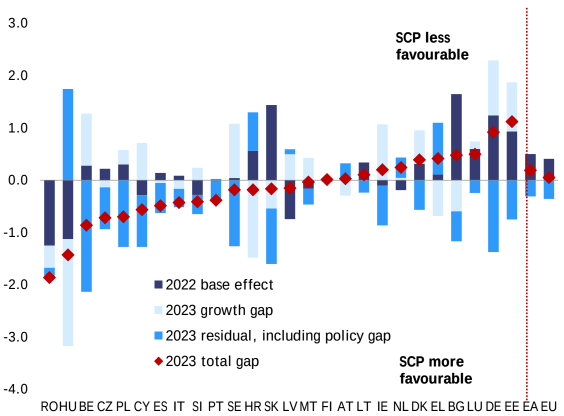
Source: European Commission 2022 spring forecast and 2022 SCPs.

Public finances are set to continue improving in 2022-2023. The Commission 2022 spring forecast and the SCPs both project further deficit decreases in more than two-thirds of Member States. The EU aggregate headline deficit is projected to decrease from 4.7% of GDP in 2021 to 3.6% in 2022 and to 2.5% of GDP in 2023, according to the Commission 2022 spring forecast, under the usual no-policy-change assumption. The deficit decrease in 2022 reflects ongoing, albeit weaker economic recovery and the reduced impact of COVID-19 temporary

(4) In quarterly terms, all Member States, except for Czechia and Spain, are forecast to reach the pre-crisis (Q4-2019) GDP level by the end of 2022.

emergency measures (Table A2.4 in Annex). At the same time, the new measures adopted by governments to mitigate the impact of high energy prices on households and firms and to provide assistance to displaced persons from Ukraine weigh on the 2022 deficit in almost all Member States, but with different degrees (Box 2.2). In 2022, deficits are expected to remain above 3% of GDP in 17 Member States, based on the Commission forecast.

Graph 2.3: **Decomposition of difference between SCPs and Commission forecast: change in the headline deficit, 2023 (pps. of GDP)**



Note: The graph shows a decomposition of the difference between the change in the deficit figure between 2022 and 2023 as per the SCPs and Commission forecast into (i) base effect, (ii) difference in a standardised measure of the growth gap and (iii) a residual. The growth gap is calculated multiplying the difference in nominal growth assumptions times the standard OECD semi-elasticities. The residual includes the so-called "policy gap", i.e. the difference in the evaluation of budgetary measures. It also includes possible differences in revenue elasticities or interest payments. Values below zero imply that the component has a deficit reducing effect in the SCPs relative to the Commission 2022 spring forecast, while values above zero indicate that the component increases the SCPs deficit relative to the Commission forecast. The sum of the components is the difference between the COM headline balance forecast and the SCP headline balance forecast.

Source: European Commission 2022 spring forecast and 2022 SCPs.

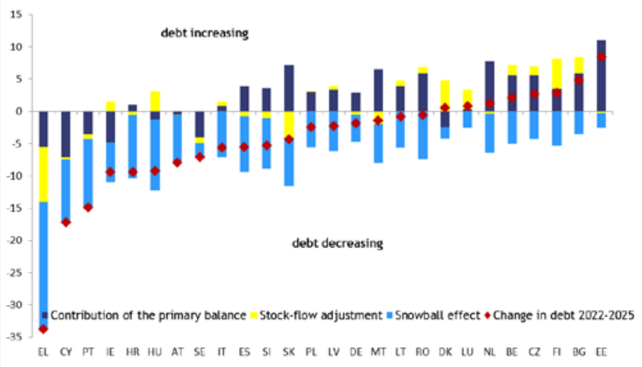
In 2023, deficits are set to continue declining, as the economic recovery continues and the remaining temporary measures put in place during the pandemic and - based on the assumption that energy prices would return to their pre-2022 level- to mitigate the impact of the high energy prices are projected to be phased out. The deficits of 11 Member States are expected to remain above 3% of GDP in 2023, based on the Commission forecast (Table A2.2 in Annex). The SCPs plan broadly the same EU aggregate deficit in both 2022 and 2023. Still, in 2023, more than half of SCPs' planned deficits are smaller than in the Commission forecast mainly reflecting the policy gap (Graph 2.3). Despite the SCPs' planned improvement, the 2023 deficit-to-GDP ratios would still remain above the 2019 level in 25 out of 26 Member States that have submitted the SCPs (Table A2.2 in Annex and Graph 2.2).

The SCPs plan further deficit reductions in 2024 and 2025. Budgetary plans in the SCPs point to a deficit decline of 0.4% of GDP for the EU aggregate in 2024 and of 0.5% in 2025. This is the result of the projected continued recovery and the planned fiscal adjustments, with the latter mainly reflected in a planned increase in net primary current expenditure below medium-term potential growth (see also section 3). All SCPs plan a deficit below 3% of GDP by 2025. In the past, in case the return to 3% of GDP at the end of the SCP horizon implied a strong fiscal consolidation in the outer years, it did not materialise. This was attributed to a postponement of the needed adjustments at the end of the SCPs ('backloading'), further shifted from one SCP to the next ('moving target effect').

The aggregate EU debt-to-GDP ratio is projected to decrease in 2022-2023 and even more so in the SCPs. On the basis of the SCPs, the EU aggregate debt ratio is set to fall from 82.2% of GDP in 2022 to 80.5% in 2023 (Table A2.1 in Annex) in line with the Commission 2022 spring forecast, which projects the aggregate debt ratio at 82.1% of GDP in 2022 and 80.4% of GDP in 2023. ([5]) According to both sets of projections, by end-2023, the debt ratio is forecast to remain well over 100% of GDP in 5 Member States (Belgium, Greece, Spain, Italy and Portugal) ([6]), compared with only 3 Member States before the pandemic (Greece, Italy and Portugal). Annex 1 presents the updated assessment of risks to debt sustainability.

([5]) For the reason of comparability, these aggregate debt ratios exclude France.
([6]) Based on the Commission forecast, by 2023 the debt ratio is forecast to remain well over 100% of GDP also in France.

Graph 2.4: **Decomposition of the change in the debt ratio: 2022-2025 (pps. of GDP)**



Source: 2022 SCPs.

The favourable interest rate-growth differential drives the decline in the debt-to-GDP ratios over the programme horizon. The majority of the SCPs project a decrease in the debt ratio between 2022 and 2025 (Graph 2.4). This is because of a favourable interest rate-growth differential ('snowball effect').(7) The projected increase in nominal GDP, also due to a rather high GDP deflator inflation, is set to have a sizeable debt-decreasing impact over the SCPs' time horizon, while higher interest rates will affect the implicit cost of debt only in the longer term.(8) The planned primary deficits would prevent debt from falling below its current (2021) levels by the end of the programmes' horizon (2025) in Belgium, Czechia, Estonia and the Netherlands. In Bulgaria, Denmark, Luxembourg and Finland, the debt ratio would remain above its 2021 level because of the projected debt-increasing stock-flow adjustment.

Heightened uncertainty and strong downside risks to the economic outlook in the context of war in Europe, unprecedented energy price hikes and continued supply chain disturbances warrant the extension of the general escape clause of the Stability and Growth Pact through 2023. In the context of the war in Europe, unprecedented energy price hikes and continued supply chain disturbances, the state of the EU and euro area economy has not returned to more normal conditions. Moreover, the decision on the continued application or deactivation of the general escape clause should also consider the need for fiscal policy to be able to respond appropriately to the economic repercussions of Russia's military aggression against Ukraine including from energy supply disruptions. The continued activation of the general escape clause will provide the space for national fiscal policy to react promptly when needed, while ensuring a smooth transition from the broad-based support to the economy during the pandemic times towards an increasing focus on temporary and targeted measures and fiscal prudence required to ensure medium-term sustainability. The Commission considers that the conditions to maintain the general escape clause in 2023 and to deactivate it as of 2024 are met. The Commission will provide orientations on possible changes to the economic governance framework after the summer break and well in time for 2023.

(7) The "snowball effect" captures the impact of interest expenditure on the annual accumulation of debt, as well as the impact of real GDP and GDP deflator growth on the debt ratio.

(8) While a higher increase in HICP inflation than in the GDP deflator in 2022 and 2023 suggests an overall impact of higher inflation would be deficit-increasing, higher inflation measured with the GDP deflator would have a positive impact on debt-to-GDP developments in the short term. This is due to a more favourable interest rate-growth differential (snowball effect) than otherwise. A higher GDP deflator will increase the denominator (nominal GDP), with a mechanical reduction in the debt-to-GDP ratio. The higher the debt-to-GDP ratio, the bigger will be the debt-decreasing impact of higher inflation.

Box 2.1: **Independent assessment of forecasts underpinning the 2022 SCPs**

Credible macroeconomic forecasts enable realistic budgetary projections and contribute to debt sustainability. This is why EU legislation obliges euro area Member States to have their macroeconomic forecasts either produced or endorsed by national independent fiscal institutions (IFIs) ([1]) and to indicate whether also their budgetary forecasts have been produced or endorsed by such institutions. For all EU Member States, national projections should be compared to the Commission forecast and, if appropriate, those of other independent bodies ([2]).

Several institutional arrangements for the production or assessment of macroeconomic forecasts exist in the euro area Member States. Macroeconomic forecasts are either produced by national IFIs (Belgium, Luxembourg, Netherlands, Austria and Slovenia) or produced by Ministries of Finance but endorsed by national IFIs (Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Latvia, Lithuania, Malta and Portugal) or by committees of experts (Germany and Slovakia). 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.

Most IFIs endorsed the macroeconomic forecasts underpinning the 2022 SCPs. In general, forecasts were deemed realistic, albeit surrounded by unusually high uncertainty stemming from high inflation and the fallout from the Russian invasion of Ukraine. The latter was mentioned as a source of particular uncertainty in many Eastern European Member States. As the Belgian IFI produced its forecast before the Russian attack on Ukraine, the forecast had to be complemented with estimates of the impact of recent events, based on forecasts by the OECD and other independent institutions.

In a few cases, the IFI was not in a position to issue an endorsement. As the French government will only submit a Stability Programme after the June parliamentary elections, the French IFI has not yet been able to assess the macroeconomic and budgetary plans of the government. The Portuguese IFI decided not to assess the Stability Programme ahead of its submission to the Portuguese Parliament by the outgoing government, as it did not include a medium-term policy scenario outlining the different policy measures and the government expenditure ceilings for the medium term. It invited the new government to submit a more comprehensive programme, which it could assess.

Outside the euro area, practices vary. Whereas some IFIs review the macroeconomic forecasts underpinning annual budgets, they do not always assess the forecasts on which Convergence Programmes are based. In Czechia, however, the Committee on Budgetary Forecasts assessed the recent macroeconomic scenario and the general government revenue forecast produced by the Czech Ministry of Finance as realistic. In addition, the Croatian IFI will also assess the government's Convergence Programme, but only in June.

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

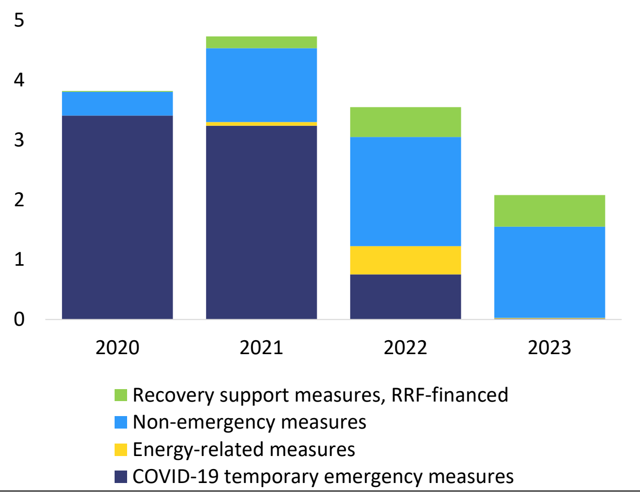
2.2. DISCRETIONARY MEASURES DRIVING BUDGETARY POSITIONS

Fiscal policy faces multiple shocks and increased uncertainty. COVID-19 temporary emergency measures, recovery support measures and energy-related measures are the three main types of measures taken by Member States, with a significant budgetary impact in the 2020-2023 period. The crisis generated by the COVID-19 pandemic led Member States to implement temporary emergency support measures ([9]) aimed at stabilising their economies and mitigating the impact of the shock on households and firms. As growth resumed, *recovery support measures* were also introduced ([10]). Some of them were

([9]) COVID-19 temporary emergency measures are 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. COVID-19 temporary emergency measures are excluded from the calculation of the fiscal stance (see section 2.3 on the country-specific fiscal stance).
([10]) Recovery support measures include 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.

funded by national budgets (defined as *non-emergency measures* in Graph 2.5), while others benefitted from EU grants through the Recovery and Resilience Facility (RRF). The simultaneous rebound in global demand coupled with supply bottlenecks led to an increase in energy prices and commodity prices already in the last part of 2021. This was further exacerbated by the Russian invasion of Ukraine and led to the introduction or strengthening of temporary measures by Member States in 2022 to cushion the effects on households and firms (*energy-related measures*). The war in Ukraine also gave rise to additional fiscal costs to support the people fleeing the fighting into the EU.

Graph 2.5: **Discretionary fiscal measures by type in the EU, 2020-2023 (% of GDP)**



Note: The fiscal measures related to the support of people fleeing the fighting in Ukraine are not included in the graph as they represent a horizontal technical assumption made for all Member States in the Commission 2022 spring forecast.

Source: European Commission 2022 spring forecast.

COVID-19 temporary emergency measures are projected to be increasingly replaced by measures to support the recovery in 2022. Based on the Commission 2022 spring forecast, COVID-19 temporary emergency measures represent 21% of the total discretionary fiscal measures implemented by Member States in 2022, down from around 68% in 2021 and nearly 90% in 2020. Among others, this reflects the successful vaccination campaign in the EU and the adaptation of economies to the changes induced by the COVID-19 pandemic. Moreover, there has been a shift in focus towards supporting the recovery and, since 24 February 2022, dealing with the new challenges stemming from the Russian invasion of Ukraine. Nevertheless, these measures will still amount to 0.8% of GDP, down from 3.2% of GDP in 2021 (Graph 2.5) and are expected to be phased out by 2023. A significant amount of the COVID-19 temporary emergency measures was financed by Member States through back-to-back loans provided by the EU under the temporary Support to mitigate Unemployment Risks in an Emergency (SURE) instrument. Over EUR 94 bn (1.7% of the aggregate GDP of the beneficiary Member States in 2020 ([11])) in financial assistance was allocated to 19 Member States, of which almost EUR 92 bn was disbursed as of 29 March 2022. Seven Member States recently expressed interest in receiving additional support from the EUR 5.6 bn still available under the instrument. In addition to direct budgetary support for businesses and households, Member States have provided liquidity support to counter the economic fallout from the COVID-19 pandemic. The most common forms of liquidity support were state guarantees to support existing and new borrowing by businesses, and tax deferrals (the possibility of delaying tax payments without penalty). Unless guarantees are called, they are considered as financial transactions and are not part of the deficit. Due to statistical reliability, guarantees are not analysed in the current note. ([12])

COVID-19 temporary emergency measures still provide significant fiscal support in 2022 in many Member States. All countries are unwinding their COVID-19 temporary emergency measures in 2022, but their budgetary impact is set to remain above 1% of GDP for 8 Member States (Bulgaria, Lithuania,

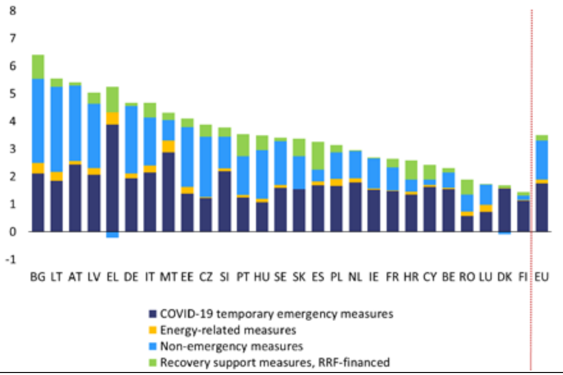
([11]) The figure expressed as a percentage of the aggregate GDP of the beneficiary Member States should take into account the caveat that the activity related to the SURE instrument was stronger in certain months of the year and weaker in other months. A more accurate representation of the financial assistance provided by SURE in terms of GDP would be obtained by using the GDP of the months where spending on SURE occurred.

([12]) Data on guarantees reported in SCPs are difficult to compare across countries given differences in coverage and missing data, while comprehensive data for 2021 are not yet available from Eurostat. Data on tax arrears are not consistent across countries.

Italy, Austria, Germany, Greece, Sweden and Malta) and between 0.5% and 1% of GDP in 7 other Member States (Latvia, Estonia, Portugal, Slovenia, Slovakia, the Netherlands and Ireland). This is due to new variants of the virus, which led to new waves of contagion at the end of 2021 and the beginning of 2022 that required new restrictive measures. Only three Member States (Hungary, Poland and Denmark) are projected to completely withdraw their COVID-19 temporary emergency measures this year.

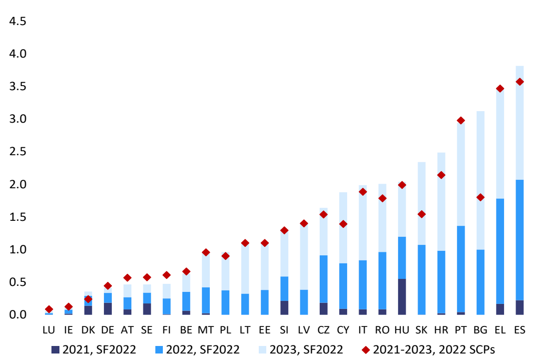
RRF grants will provide significant funding to the measures to support the recovery. Based on the Commission 2022 spring forecast, the magnitude of recovery support measures at the EU aggregate level is set to increase to 2.3% of GDP in 2022 from 1.4% of GDP in 2021, and will remain relatively stable at 2.1% of GDP in 2023. Around three quarters of these measures would be financed by the national budgets in both 2022 and 2023 (*non-emergency measures*), with the remainder one quarter being financed by RRF grants. This aggregate trend is confirmed at the individual country level. The exceptions among high-debt Member States are Greece and Spain, where most of the recovery measures would be funded by RRF grants. In the cases of Romania and Portugal, the funding is rather equally distributed between national budget financing and RRF grants. Among low/medium debt Member States, most of the recovery measures will be funded by RRF grants in Croatia and Slovakia (Graph 2.6).

Graph 2.6: **Type of discretionary fiscal measures by Member State 2020-2023 (% of GDP)**



Note: The graph represents for each Member State the average for the 2020-2023 period for each type of measure.
Source: European Commission 2022 spring forecast.

Graph 2.7: **Expenditure financed by RRF grants 2021-2023 (% of GDP)**



Note: SCP data on expenditure financed by RRF grants are not available for the Netherlands as the RRP plan has not been submitted and approved yet.

The data for 2021 is based on the 2022 Commission spring forecast, while the data for 2022 and 2023 is based on the 2022 Commission spring forecast for the histogram and the 2022 SCPs (in cumulated terms) for the red marker.

Source: European Commission 2022 spring forecast and 2022 SCPs.

Member States plan to accelerate the absorption of RRF grants in 2022-2023. The Commission 2022 spring forecast projects an increased absorption of RRF grants in 2022 compared to 2021, which is set to continue at a similar pace in 2023 (graph 2.7). Overall, expenditure financed by RRF grants in the 2021-2023 period is expected to represent more than 1% of their respective GDP for 7 Member States, more than 2% of GDP for 5 Member States and more than 3% of GDP for 3 Member States. The 2022 SCPs project a similar absorption of RRF grants over the 2021-2023 period for most Member States, with only a few exceptions. The RRF-related expenditure will be a key driver of public investment contributing to addressing the massive investment needs required by the twin transitions and the need to reduce dependence from Russia's fossil fuel as soon as possible (Box 2.4).

The budgetary impact of the temporary measures to mitigate the surge in energy prices is set to increase in 2022. In the last part of 2021, a synchronised rebound in global activity coupled with supply bottlenecks ([13]) led to a first acceleration in energy prices. Many Member States implemented measures amounting to 0.1% of EU aggregate GDP that aimed at cushioning the impact on the balance sheets of households and firms. The Russian invasion of Ukraine triggered renewed upward pressure on energy prices in 2022 given the importance of Russia as one of the world's largest exporters of fossil fuels. In response, almost all Member States implemented measures aimed at mitigating the impact of high energy prices. They consisted in changes in indirect taxes, subsidies on energy products or production and price caps in energy markets ([14]), and represented an additional 0.5% of GDP (on top of 0.1% measures already introduced in 2021) or nearly 14% of the total amount of discretionary fiscal measures implemented by Member States in 2022 (Graph 2.5 and Box 2.2). Countries that had already taken measures in 2021 strengthened them, while others only introduced them in 2022. In 12 Member States (Belgium, Bulgaria, Latvia, Estonia, Italy, Germany, Malta, Poland, Portugal, Romania, the Netherlands and Luxembourg) the net budgetary impact of these measures amount to between 0.5% and 1% of their GDP, while in the case of Greece, Hungary and Lithuania they are above 1% of GDP. In contrast, Slovakia did not take any measures specifically aimed at energy prices, production or consumption neither in 2021, nor 2022 (Graph 2.6). Most Member States plan in their SCPs to phase out the greater part of these measures in 2023 when they will only represent around 0.01% of GDP on aggregate in the EU. If the measures put in place to mitigate the impact of high energy prices are temporary and targeted towards vulnerable([15]) households and firms, this will have a more limited impact on public finances. Moreover, these measures should not reduce incentives for energy efficiency and green investment, while reflecting the need to avoid amplifying the inflationary effects of ongoing supply and demand shocks.

([13]) These included record low gas storage levels in European storing facilities and unfavourable weather conditions which had a negative impact on renewable energy generation.

([14]) With energy prices soaring, price caps often lead to substantial losses for public energy providers and distribution companies. When such companies are classified inside general government, such losses imply a direct budgetary cost of the price cap. But also for companies outside general government, significant losses are often compensated by the government in the form of subsidies or capital transfers, adding to the general government deficit.

([15]) In this regard, more reflection is necessary as to the exact definition of vulnerable households, as other factors, apart from income, would have to be considered.

Box 2.2: Measures to mitigate the impact of energy prices on households and firms and their budgetary cost

Member States have deployed a range of policies to mitigate the direct economic and social impact of high energy prices on households and firms. In this context a key policy objective is to protect low-income households (who, on average, spend a larger share of their disposable income on energy) and to shield firms in energy intensive industries from this sudden price volatility.

A distinction can be made broadly between price and income policies. Price policies directly target the final energy price paid by households and firms. These policies can include lowering indirect taxation (including excise duties on energy), reducing levies or increasing subsidies for energy products, as well as direct interventions in price setting. Income policies entail some form of monetary compensation paid to energy consumers. Often, as they have by design a social purpose, they can also be more easily targeted to vulnerable groups, through means-testing. Other measures include support to firms (in particular in energy intensive industries) and revenue raising measures (including taxes on windfall profits generated by exceptionally high energy prices).

Income policies targeted to the most vulnerable households have several advantages over price policies, but may be more difficult to implement. Price policies reduce the signalling effect of higher energy prices on demand and, as such, may reduce incentives to increase energy efficiency or to shift to alternative energy sources. Income policies, on the other hand, do not interfere with the price signals and keep the incentive to reduce demand following the rise in energy prices. Income policies targeted to vulnerable households are also likely to be less costly for the public than price policies, though this depends on design features. Presumably, income policies may also be easier to remove when energy prices stabilise to avoid that those policies outlive their motivation. Well-targeted income policies require some form of means-testing, and are therefore easier to implement if they can be linked to other means-tested benefits.

The Commission 2022 spring forecast estimates the cost of new discretionary measures to mitigate the short-term economic and social impact of high energy prices at 0.6% of GDP in the EU. This estimate includes those measures that specifically target energy prices, consumption and production. It does not include the impact of broader measures in response to the increase in overall inflation or support to firms suffering from a general slowdown in economic activity. The overall budgetary cost of the current crisis will also exceed these estimates because of (semi-)automatic adjustments of social benefits to the general price level (which are not considered to be a ‘measure’) or the impact of the deceleration in economic activity on tax collection. To some extent, this may also explain relatively large differences in the impact of energy-related measures across Member States, as some may rely more on automatic adjustment mechanisms than others, or opt for policies that are less strictly tied to energy prices. Most measures entered into force in early 2022, and have generally been announced as temporary. However, their fiscal costs will ultimately hinge upon the future developments in energy prices, and for how long those measures will apply.

Price policy measures mainly in the form of cuts in indirect taxation represent the majority of measures announced so far. Less than one third of the impact can be attributed to income policies (i.e. social and other transfers to households), often in the form of relatively untargeted transfers. On the whole, measures taken so far are often not very targeted and may often prove difficult to reverse in the future.

While aiming at a fairer distribution of higher energy costs across society, these policies do not address the underlying problem of an overreliance on (imported) fossil fuels. Cushioning the immediate impact of the current high energy prices can only be a short-term response and needs to be complemented by structural policies to improve resilience towards similar external shocks in the future. At the EU level, the RRF and the RePowerEU plan will help speed-up such investments and reforms.

(Continued on the next page)

Box (continued)

Table 1- Budgetary cost of discretionary measures to counteract the impact of energy price increases

MS	Budgetary cost (levels in % GDP)			Budgetary cost (mln EUR)		
	2021	2022	2023	2021	2022	2023
BE	0.01	0.55	0.02	72	2 957	120
BG	0.65	0.88	0.00	440	670	0
CZ	0.09	0.06	0.00	211	172	0
DK	0.00	0.08	0.00	0	269	0
DE	0.00	0.66	0.01	0	25 317	250
EE	0.21	0.72	0.00	65	241	0
IE	0.01	0.17	0.01	24	803	56
EL*	0.54	1.10	0.05	991	2 177	100
ES	0.13	0.41	0.00	1 602	5 306	0
FR	0.19	0.74	0.00	4 780	19 400	0
HR	0.00	0.35	0.18	0	215	116
IT	0.27	0.54	0.00	4 738	10 135	-60
CY	0.07	0.18	0.00	16	46	0
LV	0.08	0.88	0.00	26	315	0
LT	0.00	1.20	0.02	0	729	16
LU	0.00	0.82	0.20	0	643	165
HU	0.38	1.19	0.74	580	1 935	1 282
MT	0.46	0.98	0.60	67	152	100
NL	0.00	0.71	0.00	0	6 532	0
AT	0.00	0.36	0.16	0	1 551	740
PL	0.00	0.96	0.00	22	5 929	0
PT	0.00	0.56	0.00	0	1 290	0
RO	0.04	0.70	0.05	105	1 871	152
SI	0.00	0.41	0.00	0	229	0
SK	0.00	0.00	0.00	0	0	0
FI	0.00	0.05	0.00	0	142	0
SE	0.00	0.35	0.00	0	1 960	0
EU	0.09	0.58	0.02	13 739	90 985	3 036
EA	0.10	0.60	0.01	12 381	77 965	1 487

* In the case of EL, in 2022, 0.6% of GDP of the budgetary costs is covered by windfall revenues from emission allowances, which for the purpose of this table has not been recorded as an energy related measure.

The fiscal costs to support the people fleeing the war in Ukraine to the EU are based on technical assumptions in the Commission 2022 spring forecast. In contrast to the measures presented above, which are based on the estimates presented by Member States, the fiscal costs to support the people fleeing the war in Ukraine are based on a series of horizontal assumptions due to a high level of uncertainty over unfolding events. The fiscal estimates take into account that some of those arriving will take up work and that the labour market behaviour of Ukrainian nationals may resemble that of EU mobile workers. Specific assumptions were made regarding the cumulative net inflows of people fleeing the war in Ukraine into the EU in 2022 and 2023, as well as their distribution across Member States and their integration in the labour market (Box 2.3).

Box 2.3: **The fiscal cost for Member States of hosting people fleeing the war in Ukraine**

The people fleeing the war in Ukraine were granted temporary protection by the European Council. On March 4 an implementing decision was unanimously adopted based on the emergency mechanism, foreseen by the 2001 Temporary Protection Directive, which aims to provide an immediate and collective protection to displaced persons not in a position to return to their country of origin. Persons receiving temporary protection are entitled to rights with regard to residence, labour market access, housing, medical assistance, social welfare to cover subsistence needs, and education for children. ([1])

Specific assumptions were made to project the associated budgetary costs of hosting people fleeing the war in Ukraine for the Commission 2022 spring forecast. They concerned: (a) the cumulative inflow of people fleeing from Ukraine to the EU in 2022 and 2023, (b) their distribution across EU Member States, (c) their integration in the labour market, and (d) fiscal costs for Member States per person hosted.

The number of people arriving in the EU. Projections related to the number of people fleeing the conflict to the EU are surrounded by major uncertainty concerning the development of the war. The technical assumption underlying the Commission 2022 spring forecast was that geopolitical tensions would remain elevated over 2022 and 2023. Based on the available data, as well as the observed pattern of the slowing of arrivals, it was assumed in a central scenario that the number of people fleeing the war in Ukraine to the EU would gradually reach 6 million by the end of 2022, and stay stable over 2023.

The geographical distribution of arrivals. A large majority of people arrived in the EU Member States bordering Ukraine. However, not all refugees stay in the country of their arrival: many move to other countries, as evidenced by the number of temporary protection registrations in other EU Member States. Empirical evidence on the determinants of the geographical patterns of migration show that, among other factors, the population of the destination country (which is related to its absorption capacity) and the size of the diaspora community of the same origin are typically significant determinants. Moreover, a number of EU Member States expressed willingness to host Ukrainian refugees in proportion to their absorption capacity. Based on these considerations, for the Commission 2022 spring forecast, the geographical distribution of Ukrainians staying in the EU was projected based on four criteria with equal weights: (1) the distribution of Ukrainian immigrants in the EU in 2021 (before the war); (2) the distribution of flows of Ukrainian immigrants by country over recent years (2015-20); (3) the relative population of EU Member States; and (4) the actual distribution of people fleeing Ukraine across the EU as of March 2022 (as estimated by the European Commission based on information provided by Member States). ([2])

Labour market integration. Based on the data available, people fleeing Ukraine are mostly women and children. The assumption was made that 45% of the people arriving in the EU are people of working age. There are factors which favour a more rapid labour market integration of people fleeing Ukraine compared to past waves of humanitarian migrants. In particular, they are likely to have higher qualifications, they will face less significant language barriers at least in some Member States, and they can rely on a larger network of previous migrants from the same country which can support integration. In addition, the rapid policy response at the EU and Member State level, including immediate labour market access and the right to mobility across the EU should also facilitate rapid integration. At the same time, many of the people fleeing Ukraine have care responsibilities that may slow down this process. Based on the previous arguments it was assumed that Ukrainian adult refugees may have somewhat higher employment rates than past humanitarian migrants. Based on existing studies on the labour market integration of past refugee waves and the above

([1]) For more information, see: Temporary protection (europa.eu).
([2]) Since the preparation of the projections for the 2022 spring forecast, Member States and the Commission agreed that, going forward, the number of registrations for Temporary Protection will serve as the primary source of information related to the distribution within the EU of people fleeing the war in Ukraine.

(Continued on the next page)

Box (continued)

considerations, the employment rate of working-age people arriving from Ukraine is assumed to increase from 8% (on average) in 2022 to 20% (on average) in 2023. ([3])

Gross annual fiscal costs per person. Fiscal costs per person have been estimated by the Joint Research Center of the European Commission based on Euromod, the EU's tax-benefit microsimulation tool. ([4]) The estimated fiscal costs include cash transfers as well as in-kind benefits (health care, education and housing), reflecting relevant data from each Member State. The resulting estimation of gross annual fiscal costs per person ranges from about EUR 1200 to about EUR 19000 across Member States. Fiscal estimates take into account that some people will take up work over the forecast horizon. For those who start to work, the fiscal cost is assumed to be reduced by one-half, reflecting the reduced need for cash transfers.

([3]) Studies of the 2015-2016 migration wave include: Brücker, H., Croisier, J., Kosyakova, Y., Kröger, H., Pietrantuono, G., Rother, N., Schupp, J. (2019). Second wave of the IAB-BAMF-SOEP Survey: Language skills and employment rate of refugees improving with time. (BAMF Brief Analysis, 1-2019). Nürnberg: Bundesamt für Migration und Flüchtlinge Forschungszentrum Migration, Integration und Asyl. https://nbn-resolving.org/urn:nbn:de:0168-ssoar-77905-9. For a 2014 EU study on the labour market integration of refugees, see: European Commission (DG EMPL) and OECD: "How are refugees faring on the labour market in Europe? A first evaluation based on the 2014 EU Labour Force Survey ad hoc module" Working paper. URL: https://ec.europa.eu/social/BlobServlet?docId=16130&langId=en.

([4]) Calculations are based on the methodology described by Christl M., Bélanger A., Conte A., Mazza J. & Narazani E. (2021), The fiscal impact of immigration in the EU, JRC Working Papers on Taxation and Structural Reforms No 01/2021, European Commission, Joint Research Centre, Seville. URL: https://joint-research-centre.ec.europa.eu/system/files/2021-04/jrc124744.pdf.

2.3. COUNTRY-SPECIFIC FISCAL STANCE ([16])

2.3.1. Fiscal stance across countries

The COVID-19 pandemic poses specific challenges to the assessment of the fiscal stance. The extension into 2021-2022 and subsequent phasing-out in 2023 of sizeable COVID-19 temporary emergency measures 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 helps to avoid misleading inferences on the evolution of demand support since the start of the pandemic.([17])

In order to assess whether national fiscal policy is prudent and its composition is conducive to a sustainable recovery consistent with the green and digital transitions, attention is paid to the

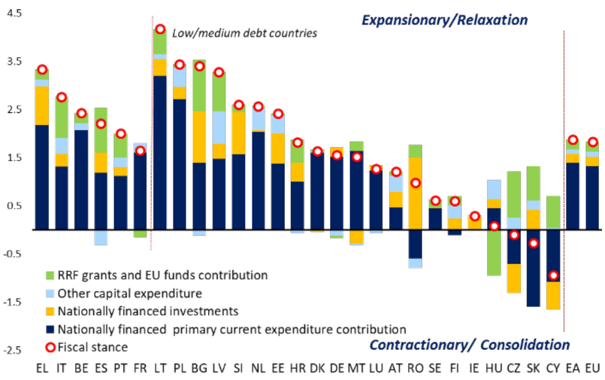
([16]) The analysis of the fiscal stance presented in this section is based on the Commission 2022 spring forecast, which also includes the information incorporated in the Stability Programmes. The fiscal stance indicator - and components - is the same as the one used for the Council fiscal recommendations for 2022 and 2023. The fiscal stance is measured as the change in primary expenditure (net of discretionary revenue measures), excluding Covid-19 crisis-related temporary emergency measures but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to medium-term potential growth. In the Commission 2022 spring forecast, COVID-19 temporary emergency measures (mainly transfers to support households, workers and firms) are estimated to have affected the euro area general government deficit in 2020-2022, by 3½% of GDP in both 2020 and 2021 and by ¾% of GDP in 2022. They are set to be completely phased out in 2023. These measures are excluded from the fiscal stance in 2020-2023 mainly because the timing of their expansionary/contractionary impact on the economy does not necessarily correspond to the years in which they are introduced/removed. Health restraints have in fact implied the impossibility of producing and spending on several economic activities during the pandemic, notably contact services, which led to a significant increase in the euro area household savings rate in 2020 and 2021 (19.4% and 17.3% of disposable income) compared to the 2019 pre-pandemic level (13.1%). Moreover, a significant part of these measures is related to short-time work schemes that have implied lower cyclical unemployment benefits, which are excluded from the expenditure aggregate used for the fiscal stance.

([17]) Crisis-related emergency measures generally aim at addressing the public health situation and compensating workers and firms for income losses due to lockdown measures and supply chain disruptions. These measures are mostly of a temporary nature, but their impact is contingent on the development of the health situation. While useful in the initial phase of the crisis, these measures are likely to be less efficient to support the recovery when the health related emergency gradually wanes.

evolution of nationally financed primary current expenditure (net of discretionary revenue measures and excluding COVID-19 crisis related temporary emergency measures) and investment. As fiscal policy recommendations in the current highly uncertain environment remain predominantly qualitative in nature, the fiscal guidance for both types of expenditure has been differentiated. In 2022, the growth of nationally financed primary current expenditure (net of discretionary revenue measures) should be kept under control, and be limited in high debt Member States.([18]) All Member States were recommended to preserve nationally financed investment. In addition, Member States with high debt should use the Recovery and Resilience Facility (RRF) to finance additional investment in support of the recovery, while pursuing a prudent fiscal policy. In 2023, the growth of nationally-financed primary current expenditure (net of discretionary revenue measures) should be in line with an overall neutral policy for Member States with low/medium debt. Member States with high debt should limit this growth below medium-term potential output growth. At the same time, Russia’s invasion of Ukraine, and its impact on Member States’ economies is a stark reminder of Europe’s strategic challenges, including the need for a rapid energy transition away from fossil fuels. Further decisive steps are needed towards fostering economic and social resilience, ensuring the EU’s security of energy supply and reducing its dependency on fossil fuels from Russia well before 2030.([19]) Consequently, all Member States are recommended to expand public investment for the green and digital transition and energy security. Full and timely implementation of the RRPs will be key in this respect. Lastly, fiscal policy should allow automatic stabilisers to operate and it should provide temporary and targeted measures to mitigate the impact of the energy crisis and to provide humanitarian assistance to people fleeing from Russia's invasion of Ukraine.

The fiscal stance, combining the effects of national budgets and the EU budget, is expected to remain supportive in almost all Member States in 2022. ([20]) According to the Commission 2022 spring forecast, 22 Member States will provide a clearly supportive fiscal stance, with an average annual expansion of at least 0.5% of GDP (Graph 2.8). A broadly neutral stance is projected for Cyprus, Czechia and Hungary.([21]) All high debt Member States, which were recommended a prudent fiscal policy in 2022, plan a fiscal expansion. In the majority of countries, including those with high debt, the projected supportive fiscal stance reflects higher nationally-financed current spending or tax cuts.

Graph 2.8: **Fiscal stance in 2022 (% 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 2022 spring forecast.

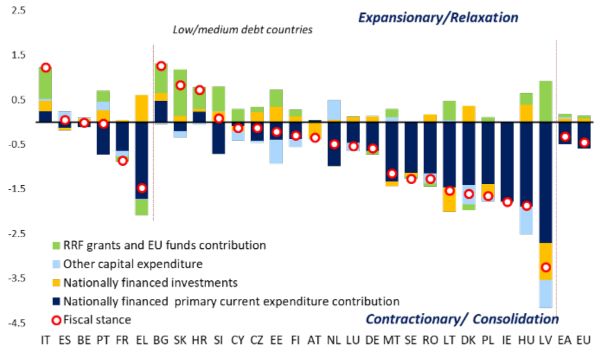
([18]) The recommendation to keep under control and limit the growth of net current expenditure in 2022 was given in June 2021 to low/medium and high-debt Member States, respectively, that were projected to have an expansionary contribution from this fiscal stance component of more than ½ pps of GDP, based on the Commission 2021 spring forecast. The recitals of the 2022 Country-Specific Recommendations (CSRs) now indicate when a ‘significant’ expansionary contribution (i.e. more than ½ pps of GDP) of this component is projected in 2022 based on the Commission 2022 spring forecast, with a list of the main drivers.

([19]) See REPowerEU Communication, COM(2022) 230 final

([20]) See Glossary for details on how the fiscal stance is computed.

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

Graph 2.9: **Fiscal stance in 2023 (% of GDP) (22)**



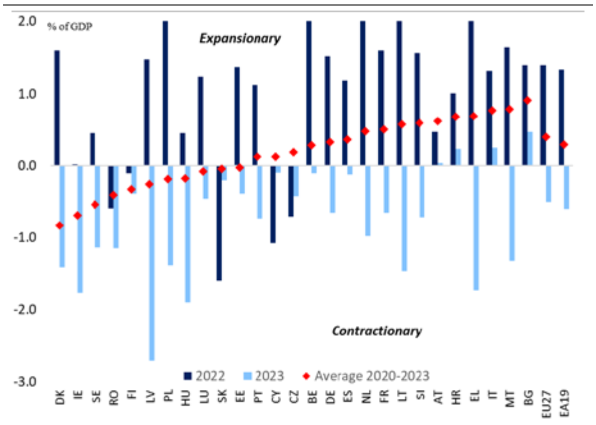
Source: 2022 European Commission spring forecast.

The fiscal stance is projected to turn clearly contractionary in about half of Member States in 2023 under the usual no-policy-change assumption (Graph 2.9). Fourteen Member States are projected to have a clearly contractionary fiscal stance of at least 0.5% of GDP. Two more countries are forecast to display a slightly contractionary fiscal stance. In addition, most nationally-financed investment and expenditures financed by the RRF (23) and other EU funds are set to provide broad-based support to a sustainable recovery. A contractionary contribution of nationally-financed investment is however projected for Latvia, Lithuania, Poland and Austria.

The central scenario presented above should be taken with a grain of salt in the current environment. Inflation dynamics can become problematic in the outer years. Moreover, the 2023 projections were based on a no-policy-change scenario surrounded by exceptionally high uncertainty. Energy price measures might last longer especially if inflation remained high and growth remained weak. Lastly, contingent liabilities due to the COVID-19 pandemic might generate fiscal risks.

2.3.2. Components of the fiscal stance

Graph 2.10: **Growth of nationally-financed current expenditure, 2020-2023 (% of GDP; in excess of medium-term potential growth)**



Source: European Commission 2022 spring forecast.

The fiscal stance indicates the short-term impact of fiscal policy, nationally-financed as well as financed by the EU, on the economy. At the current juncture, this includes in particular sizable grants from the Recovery and Resilience Facility, while COVID-19 temporary emergency measures are excluded. Within the nationally-financed fiscal impulse, we distinguish the impact of nationally-financed investment, other capital expenditure and net primary current expenditure (see also section 3).

In most Member States, net current public expenditure is set to be expansionary in 2022 based on the Commission forecast. In about two-thirds of Member States, the projected increase in nationally-financed primary current expenditure exceeded the medium-term potential GDP growth rate in 2020-2021 with an average deficit-increasing/expansionary impact on the EU aggregate fiscal stance of more than ¼% of GDP (Graph 2.10). This deficit-increasing/expansionary impact on the EU aggregate fiscal stance is

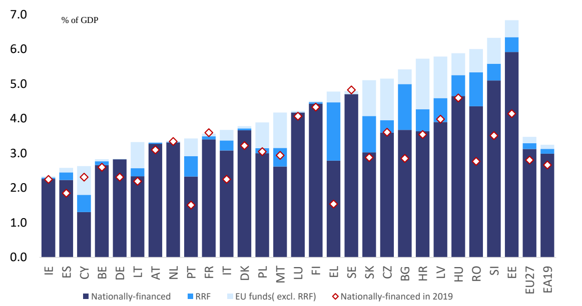
(22) The Netherlands is included in the graph even if it does not include RRF grants.
(23) Expenditure financed by RRF loans is part of nationally-financed expenditure (either current spending or investment). The financing through RRF loans allows for savings in terms of borrowing costs. Moreover, the expenditure financed by the RRF is of high quality given its inclusion in the RRPs. As the expenditure financed by RRF loans is part of nationally-financed expenditure, it is included in the fiscal stance.

expected to reach around 1½% of GDP in 2022. According to the Commission 2022 spring forecast, two high-debt Member States (Belgium and Greece) are expected to increase significantly nationally-financed current expenditure above their medium-term potential growth rate in 2022, with an expansionary contribution to the fiscal stance of over 2 pps of GDP. This includes recovery support measures as well as measures to address the impact of the increase in energy prices as currently planned. In June 2021, the Council addressed a recommendation to keep under control and limit the growth of net current expenditure in 2022 to those low/medium- and high-debt Member States, respectively, that were projected to have an expansionary contribution from this fiscal stance component of more than ½ pps of GDP, based on the Commission 2021 spring forecast.

In majority of Member States, net current public expenditure is set to become contractionary by at least ½% of GDP in 2023, assuming that energy support measures are mostly phased out in 2023. With the exception of Bulgaria, Croatia, Italy and Austria, in all Member States the nationally-financed primary current expenditure (net of new revenue measures) are set to become contractionary in 2023. In most of them, the contractionary contribution to the overall fiscal stance of the nationally-financed primary current expenditure in 2023 is projected to be at least 0.5 pps. Part of the contractionary contribution of the nationally-financed primary current expenditure is due to measures to mitigate the impact of high energy prices on households and firms which are currently projected to be almost completely phased out in 2023, while having an expansionary impact of ½% of GDP in 2022. However, if energy prices remained elevated also in 2023, some of these measures could be continued. In high-debt Member States, except for Greece, the projected growth in nationally-financed current expenditure provides a broadly neutral or contractionary contribution to the overall fiscal stance, relying on the phasing out of the measures to address the impact of the increase in energy prices as currently planned. Only Greece is projected to have a clearly contractionary contribution to the fiscal stance from net primary current expenditure, after considering the phasing out of the temporary measures to mitigate the impact of high energy prices taken in 2022. For the other high-debt countries, excluding the measures related to energy prices, a broadly neutral contribution (France and Portugal) or an expansionary one (Spain, Italy and Belgium) is forecast. The growth of nationally-financed primary current expenditure (net of discretionary revenue measures) should be in line with an overall neutral policy in 2023 for Member States with low/medium debt. Member States with high debt should limit the growth of nationally-financed net primary current expenditure below medium-term potential output growth in 2023. In Belgium, Spain and Italy an expansionary contribution from net current expenditure of more than ½% of GDP is expected over 2022-2023 on average. Among low/medium-debt Member States, Czechia, Ireland, Hungary, Latvia and Slovakia are expected to somewhat restrain the growth of their nationally financed current expenditure over 2022-2023, with a contractionary impact of more than ½ pps of GDP on average.

The share of public investment in GDP is expected to increase in 2022-2023, with around a quarter of the increase being financed by the EU budget, mainly through the RRF. High-quality public investment is needed to boost growth potential, ensure a sustainable and inclusive recovery, and enhance the resilience of the EU economy, as well as meet the substantial investment needs for the green and digital transition. The EU aggregate public investment-to-GDP ratio is projected to increase from 3% of GDP in 2019 to 3.5% in 2023. Almost all Member States are expected to spend more on nationally-financed public investment than they did before the pandemic. The only exceptions are Cyprus, France, Latvia, Malta and Sweden, where nationally-financed investment is

Graph 2.11: **Public investment in the EU, 2023**

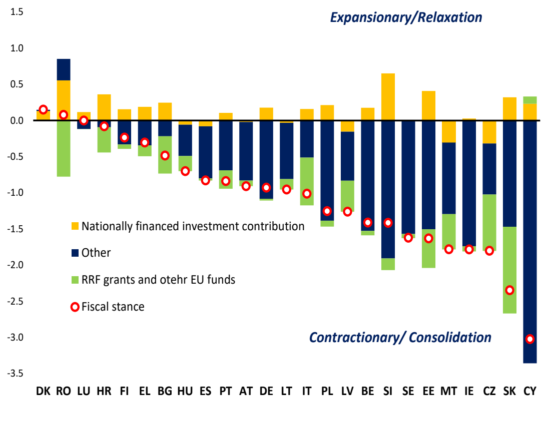


Source: European Commission 2022 spring forecast.

projected to be lower in 2023 than in 2019. In the case of Estonia, Greece, Romania and Slovenia the increase in nationally-financed investment is more than 1 pp compared to pre-pandemic levels (Graph 2.11). In addition to public investment proper, some Member States benefit from other capital transfers generally financing investment in the private sector.

The EU budget, mainly through the RRF, will finance around a quarter of the increase in the share of public investment in GDP. Expenditure financed by RRF grants ([24]) will fund high-quality investment projects and enable productivity-enhancing reforms without giving rise to higher deficits and debt in national budgets. The RRF instrument will substantially help to adress the sizeable investment needs of the EU economy until 2026. The reforms and investments proposed by Member States in their RRPs are focused to a significant extent on meeting the climate and digital transition objectives. Moreover, the RRF supports the coordinated planning and financing of cross-border and national infrastructure, as well as energy projects and reforms. This broadly corresponds to the recommendation given to all Member States to expand public investment including by making use of the RRF/REPowerEU and other EU funds. Differences in EU-financed investment between Member States depend on the allocation of RRF grants and the degree of absorption of those grants (Graph 2.7 and Box 2.4).

Graph 2.12: **Average fiscal stance planned in 2024-2025 (% of GDP)** ([25])



Source: 2022 SCPs.

The 2022 SCPs plan a contractionary fiscal stance in 2024-2025. For the period beyond 2023, Member States are invited to pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions. According to the SCPs, most Member States plan a contractionary fiscal stance on average in 2024-2025, with the exception of Denmark, Luxembourg and Romania which plan a broadly neutral fiscal stance (Graph 2.12). This follows a slightly expansionary fiscal stance expected for 2022-2023 on average, based on the Commission 2022 spring forecast, which also includes the information incorporated in the Stability Programmes.([26]) Almost all the high-debt countries, except Spain, plan in their SCPs an expansionary stance for investment and a contraction for the nationally-financed primary expenditure in 2024-2025.

([24]) Expenditures financed by loans from the RRF are included in nationally-financed expenditure (see also footnote (23) in section 2.3.1).

([25]) The Netherlands is not included in the graph as the plan does not include RRF grants. The RRP plan has not been submitted and approved yet.

([26]) The fiscal stance projected for 2022-2023 is based on the Commission forecast as SCP data on COVID-19 temporary emergency measures are not available for that period.

Box 2.4: **Investment needs and developments**

The EU economy will require massive public and private investment in the medium to long term. The green and digital transitions together with the need to enhance the resilience of the EU economy require huge public and private investment. In the next decade, the additional annual investment needs in relation to the twin transition compared to 2011-2020 are estimated at around EUR 650 billion annually. The green transition accounts for EUR 520 billion of these additional investment needs, i.e. an annual increase of approximately 2.9 percentage points of GDP (2.1 pps related to additional climate and energy investments and 0.8 pps related to additional environmental investments). Enhancing the resilience of the EU economy, including by rapidly reducing its dependence on Russian fossil fuels through the REPowerEU Plan, will require further public and private investments.

The public and private investment needs for the twin transition are country-specific. The split between public and private investment needs differs across countries and depends on several factors, including the choice of the policy instrument, the economic structure and the role of the state in the economy. The share of public investment in total investment (expressed as gross fixed capital formation) varies between Member States from 5.9% to 28.5% in 2020, with an average of about 15% for the 2011-2020 period. The wide range of this share reflects the high degree of heterogeneity across Member States, including in relation to public ownership of assets and public interventions, which are relevant for the energy related sectors. Private investments are expected to finance most of the digital transformation, as economic returns can largely be attributable to investors.

The share of public and private investment decreased in the aftermath of the Great Recession of 2008, partly as a result of policy interventions, before rebounding during the recovery phase. Private and public investment both declined substantially and persistently during the 2008 crisis, dampening growth prospects across the EU (Graph 1.a). The absence of EU-level safety nets required Member States to accelerate fiscal consolidation to re-establish their credibility with international financial markets. In this context, reducing public investment was an easy way of achieving structural improvements in their fiscal positions. Once the recovery phase occurred, private investment started picking up in 2015, while public investment remained subdued.

As the COVID-19 pandemic hit the EU economy, particular attention was paid to preventing renewed decreases in public investment. When a new shock in the form of the COVID-19 pandemic occurred in 2020, substantial monetary and fiscal policy support was put in place which allowed for a quicker and stronger recovery in both private and public investment. Moreover, an explicit recommendation was given to Member States to preserve nationally financed investment and, for 2023, expand public investment for the green and digital transition and for energy security, including by making use of the RRF, RePowerEU and other EU funds. This is expected to prevent renewed cuts to public investment in the coming years. Consequently, the public and private sectors are both projected to reach higher than pre-pandemic investment levels at the end of the forecast horizon (Graph 1.b).

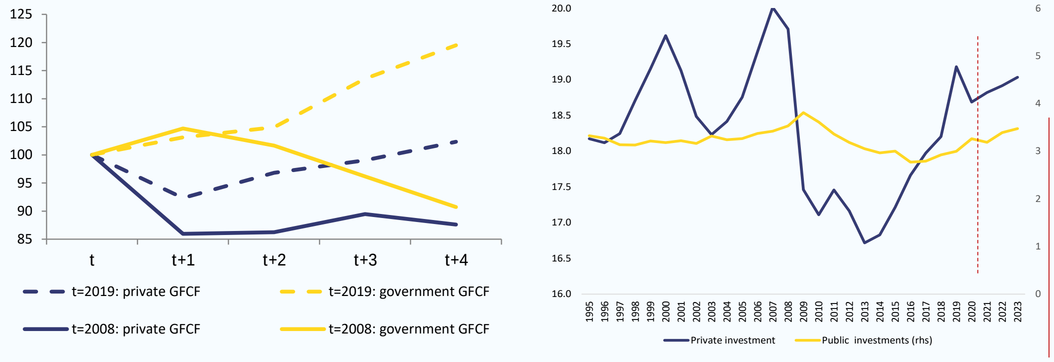
Sizeable support to public investment is provided from the EU budget. The EU aggregate public investment-to-GDP ratio is projected to increase from 3% of GDP in 2019 to 3.5% in 2023 as almost all Member States are expected to spend more on public investment than they did before the pandemic (Graph 2). Around a quarter of that increase is related to investment financed by the RRF, with the aim of supporting a sustainable and inclusive recovery, the green and digital transitions and the resilience of the EU economy.

(Continued on the next page)

Box (continued)

Graph 1: Public and private sector investment in the EU

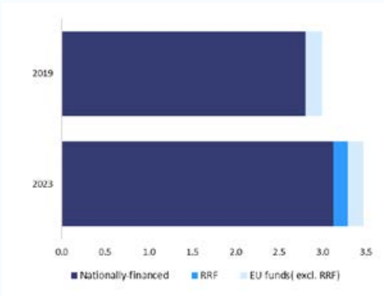
a) the great recession vs the COVID-19 crisis (index, t=100) *b)* 1995 – 2023 (% of GDP)



Source: European Commission 2022 spring forecast

The quality of public finances will be important in supporting investment over the medium to long term. As fiscal policy will have to achieve prudent medium-term fiscal positions, supporting investment will require a clear prioritisation of expenditures and efforts to improve the composition and quality of public finances. While the RRF will provide further support by bolstering potential GDP, provided that Member States consistently implement the reforms in their RRPs, it remains a temporary support instrument (up to 2026). However, investment needs of the twin transition will remain substantial in the longer term.

Graph 2: Public investments in the EU and source of financing (% of GDP)



Source: European Commission 2022 spring forecast

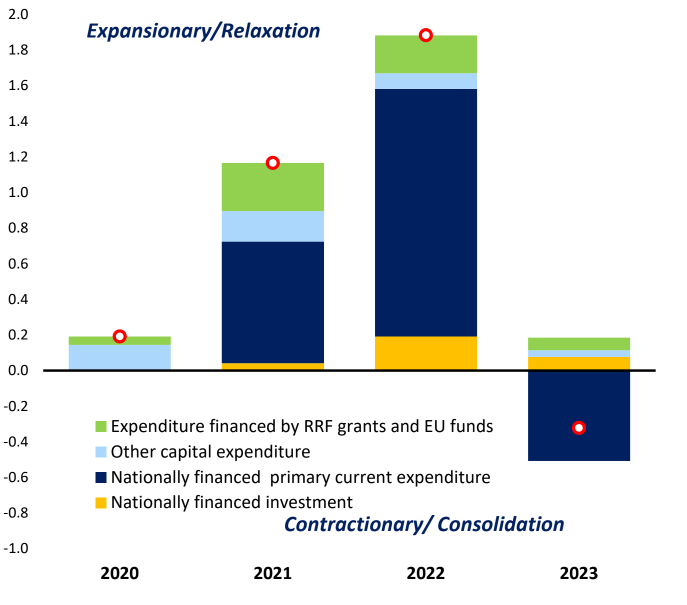
3. EURO AREA FISCAL STANCE AND THE POLICY MIX

This section focuses on the euro area as a whole looking at the aggregate fiscal stance, and its interaction with monetary policy. The euro area fiscal stance is an important dimension to consider given the existence of spillovers between Member States in a monetary union. A more detailed scrutiny of the country-specific fiscal stance is covered in section 2.3.

An adequate interaction between monetary and fiscal policies is crucial to stabilise the euro area economy and ensure sustained and sustainable growth going forward. The interdependence between these policies is even higher in a currency union where a single monetary policy and 19 national fiscal policies must provide consistent policy responses to common and idiosyncratic economic developments and shocks. In the current context, where monetary policy is entering a normalisation phase and fiscal policy is called to exit from the broad-based support provided during the pandemic towards an increasing focus on temporary and targeted measures and fiscal prudence required to ensure medium-term sustainability, monetary and fiscal policies have to act in a complementary manner and be mutually reinforcing. In particular, it appears important that inflation expectations continue to remain well anchored into the 2% ECB target and that national fiscal policies reflect the need to avoid amplifying the inflationary effects of ongoing supply and demand shocks.

3.1. EURO AREA FISCAL STANCE IN THE PERIOD 2021-2023

Graph 3.1: **Fiscal stance in the euro area (% of GDP)**



Source: 2022 European Commission spring forecast.

The euro area fiscal stance is set to remain supportive in 2022. The fiscal stance in the euro area is estimated to have been expansionary – by 1¼ % of GDP – in 2021. In the Commission 2022 spring forecast, the fiscal stance is projected to become even more expansionary in 2022, by 1¾% of GDP (Graph 3.1). In 2021, the main expansionary contribution came from nationally-financed net primary current expenditure, followed by expenditure financed by RRF grants and other EU funds, while nationally-financed investment increased broadly in line with medium-term potential growth, providing a contribution close to zero. In 2022, the more supportive fiscal stance is driven by the increasing expansionary contribution of the net primary current expenditure component. This component includes recovery support measures as well as new measures to help households and firms cope with the surge in energy prices (more than ½% of GDP) and the humanitarian assistance to displaced persons from Ukraine (0.1% of GDP). Moreover, public investment spending financed by the national budgets is expected to grow more than medium-term potential growth and thus to provide an expansionary contribution. Expenditure financed by RRF grants and other EU funds are set to increase further, with an additional expansionary contribution in 2022.

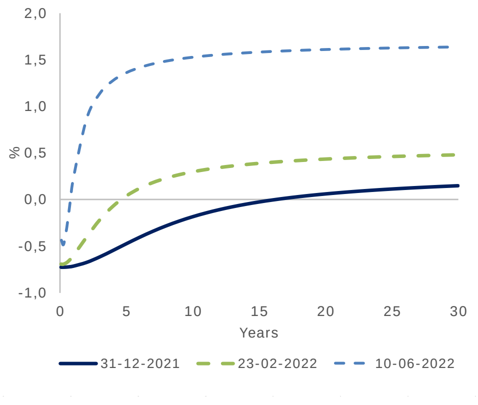
The euro area fiscal stance in 2023 is projected to be slightly contractionary. ([27]) After having been significantly expansionary in 2021-2022, in 2023 fiscal policy should remain prudent and combine higher investment with controlling the growth in net primary current expenditure. At this stage, as mentioned later in the analysis of the policy mix, a broad-based fiscal impulse to the economy in 2023 does not appear warranted, as it may add to inflationary pressures. In the Commission 2022 spring forecast, the euro area fiscal stance is projected to be slightly contractionary in 2023, at around ½% of GDP under the usual no-policy-change assumption. This contractionary stance is driven by the projected phasing out of the temporary measures to mitigate the impact of the high energy prices that are being implemented in 2022. At the current juncture, it is appropriate to ensure a smooth transition from broad-based support to the economy during the pandemic towards an increasing focus on temporary and targeted measures in a recovery situation, as well as the need for fiscal prudence. In this context, the expected further increase in RRF absorption and in nationally-financed investment across Member States appears to be consistent with the need to expand public investment for the green and digital transition and for energy security, including by making use of the RRF and other EU funds. At the same time, fiscal policy should be agile to react to high uncertainty and strong downside risks to the economic outlook related to Russia's war on Ukraine, while not undermining incentives for the energy transition. Beyond 2023, high-debt Member States should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring credible and gradual debt reduction and fiscal sustainability in the medium-term through progressive consolidation, investment and reforms, while low/medium-debt Member States should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions.

High inflation may affect the measurement of the fiscal stance. Higher inflation implies a stronger increase in spending on goods and services purchased by the government. The increase in spending on pensions, social benefits, public wages and new investment projects is also pushed up by higher inflation, likely with some delay. Since the fiscal stance is calculated based on the difference between net government spending growth and 10-year average potential growth, the overall impact of inflation on the measured fiscal stance will depend on the parallel evolution of nominal potential GDP. Whereas the growth in government expenditure is likely to be more closely related to HICP inflation rather than the GDP deflator inflation, the 10-year nominal potential GDP growth (the benchmark used to assess the stance) is affected by the increase in the GDP deflator, which can at times be very different.([28]) The GDP deflator is in fact mainly driven by developments in domestic production labour costs above productivity (i.e. Unit Labour Costs) and the increase in profit margins. The Commission 2022 spring forecast projects a higher increase in the HICP indicator than in the GDP deflator in 2022-2023. The difference between the 'spending' effect and the 'potential growth' effect would suggest an overall 'expansionary' impact of higher inflation on the fiscal stance indicators over the two years, likely larger in 2023, but timing and magnitude will be country-specific.

([27]) COM(2022) 600-625 final
([28]) Both expenditures and potential GDP are in value terms. Moreover, the nominal 10-year potential GDP is based on the Commission 2022 spring forecast.

3.2. MONETARY POLICY STANCE IN 2021-2023

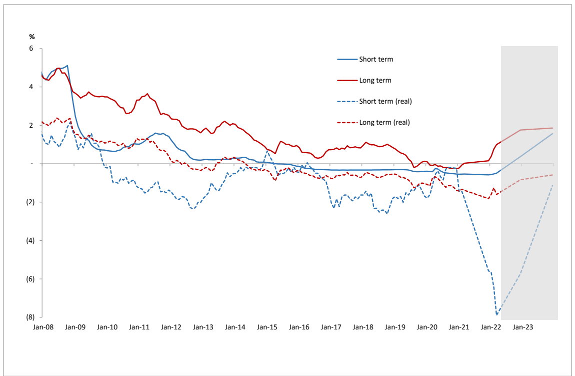
Graph 3.2: **Yield curves of AAA-rated euro area sovereigns**



Source: ECB, own calculations.

Sharply rising inflation is leading to a normalisation of monetary policy, following an accommodative stance in 2021. Monetary policy measures in 2021 were still characterised by the European Central Bank's (ECB) response to the COVID-19 crisis, even as supply bottlenecks, a nascent recovery and energy costs begun to exert pressure on prices, which have embarked on an upward trend since the beginning of last year. This trend accelerated in 2022, reaching an all-time high of 8.1% HICP inflation estimated for May in the euro area, mainly owing to the strong effects of the Russian invasion of Ukraine on global energy and food prices. The re-anchoring of medium-term inflation expectations towards policy targets has led the ECB to start phasing out existing unconventional policy measures, with the last targeted long-term refinancing operation (TLTRO III) conducted in December 2021 and net asset purchases under the pandemic emergency purchase programme (PEPP) discontinued in March 2022. At the same time, the net monthly purchases under the asset purchase programme (APP) have been gradually phased out from EUR 40 bn in April to EUR 20 bn in June 2022. Under current forward guidance of the ECB, a first increase of 25 bps in policy rates – which are currently negative – will take place in July 2022, following the last round of net asset purchases in the previous month.

Graph 3.3: **Euro area benchmark interest rates**

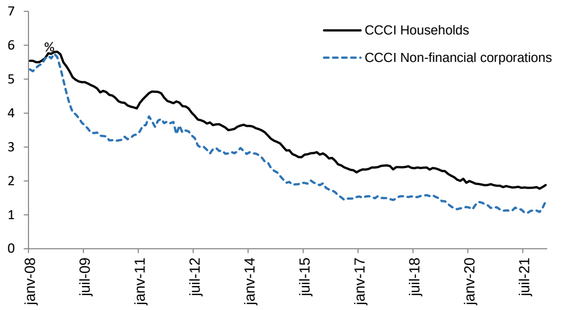


Note: Short term rate: 3M Euribor; Long term rate: 10Y interest rate swap; Real rates are derived from the respective short or long-term rate minus annual HICP inflation and average future inflation inferred from 10Y inflation swaps, respectively. Short-term nominal forecasts (derived from forward short-term rates) are deflated by ECFIN inflation forecasts. Long-term nominal forecasts (derived from forward long-term swap rates) are deflated by their respective forward inflation swaps (i.e. 1Y 10Y and 2Y 10Y forward inflation swap rates).

Source: ECB, Bloomberg, own calculations.

Financial conditions have tightened in 2022, as evidenced in rising sovereign bond yields and corporate bond spreads. Yields on 10-year AAA sovereign bonds have risen by approximately 1.7 pps in the euro area since the beginning of the year, of which 1.2 pps since the Russian invasion of Ukraine on 24 February, and are now close to 1.5% (Graph 3.2). One-year yields on risk-free bonds have so far risen less, by approximately 1 pp, and are now in positive territory. The spreads of euro area sovereigns with respect to Germany have increased moderately in the first half of 2022, though somewhat more markedly for governments that are more indebted. At the same time, corporate bond spreads have widened, particularly in the high-yield segment, while banking lending rates have increased more moderately, with bank lending remaining strong in the first quarter of the year. The downward trend in composite credit cost indicators for households and non-financial corporations appears to have run its course (Graph 3.4), while real rates have yet to show clear signs of tightening, having remained negative in the first half of 2022 in connection with the increase in actual and expected inflation (Graph 3.3).

Graph 3.4: **Composite credit cost indicators**



Source: ECB, Bloomberg, Datastream, own calculations.

The monetary policy stance is expected to continue on a normalisation path in 2022-2023. Market expectations point to progressive hikes in policy rates in 2022, with the first two already announced for July and September. Beyond September, the ECB anticipates that a gradual but sustained path of further increases in interest rates will be appropriate. Short-term risk-free rates are currently expected to turn positive in the third quarter of 2022. However, real interest rates are still projected to remain negative, even at longer maturities. As regards net asset purchases, they have ended in June as far as the APP is concerned, after their discontinuation under the PEPP already in March. The latter's reinvestment policy will continue to contemplate flexibility in order to ensure a uniform transmission of monetary policy across the euro area. Finally, survey-based data suggest a progressive tightening of bank credit standards going forward.

3.3. POLICY MIX IN THE EURO AREA 2021-2023

The euro area policy mix has shifted considerably since the pandemic outbreak in March 2020. In response to the COVID-19 crisis, vertical coordination (between national and EU policies) has in fact been added to horizontal coordination (between national policies), in contrast to what was done in response to the Great Financial Crisis. ([29]) Indeed, in addition to the ECB accommodative monetary policy and strong fiscal support at national level, the EU has intervened with direct policy support through unprecedented instruments like SURE and NextGenerationEU/RRF.

Russia's invasion of Ukraine poses a new challenge in terms of the policy mix. The resulting shock primarily affects the supply side of the economy, weighing on output growth while driving inflation to levels not seen since the introduction of the single currency (Box 3.1). In the absence of a generalised demand shortfall and in the current context of a supply-side shock characterised by high, largely imported, inflation, a broad-based fiscal stimulus does not appear warranted. It is key that fiscal policy is prudent and remains agile to react to changing circumstances against the background of the normalisation of monetary policy. Rising inflation may negatively impact on all components of demand going forward, and in turn on growth prospects. At the same time, fiscal policy should avoid amplifying the inflationary effects of ongoing supply and demand shocks, in particular for Member States experiencing high core inflation rates. Fiscal policy should also maintain an adequate level of public investment to foster in particular the climate and energy transition, and it is called to mitigate the impact of rising energy prices for vulnerable households and firms with targeted and temporary measures that maintain incentives for higher energy efficiency, while bearing in mind the need to maintain fiscal sustainability in the medium term. EU instruments, especially the RRF and REPowerEU will support Member States in implementing fiscal policies that are consistent with the goal of reducing overall reliance on fossil fuels and shifting fossil fuel imports away from Russia as soon as possible.

([29]) Buti, M. and M. Messori (2021). Euro area policy mix: From horizontal to vertical coordination. CEPR Policy Insight No 113.

Box 3.1: **The Fiscal Policy Response to Economic Shocks**

The Russian invasion of Ukraine has generated economic shocks with short and long-term implications for fiscal policy. These shocks are impacting the EU economy through a variety of channels: higher energy and commodity prices; interruptions to trade flows; the impact of firms' financial exposure to Russia; and lower business and consumer confidence. In the short term they will generate additional costs related to refugee inflows and the need to protect vulnerable households from high energy prices. In the longer term, there will be a need for additional expenditure to reduce the dependency on fossil fuel imports and increase defence capabilities.

Coming in the wake of the global financial crisis – compounded by the euro area sovereign debt crisis – and the COVID-19 pandemic, the Russian invasion of Ukraine represents the third large shock to hit the EU economy in the last 15 years. The earlier shocks led to upward shifts in the level of public debt in most EU Member States. They also illustrated the need for policy coordination in the EU, and gave rise to the creation of new common instruments to help respond to the immediate impact of the shock (EFSF/ESM, NGEU, REPowerEU) and to increase resilience to future shocks (Banking Union, Capital Markets Union).

The identification of the type and persistence of economic shocks is crucial for the design of appropriate macroeconomic stabilisation policies. Supply shocks require different policy responses to demand shocks. In a supply-driven recession, the policy response should focus on easing the specific supply restriction and introducing appropriate structural reforms, such as high-quality investment to adapt to new structural conditions. In the case of a permanent supply shock, accommodative macroeconomic policies would be counterproductive, as there is no alternative to adapting to the economy's reduced potential output. However, supportive macroeconomic policies can smooth the demand-side impact of a transitory supply shock on consumption and investment (in particular for liquidity- and/or credit-constrained households and firms).

The current economic situation is characterised by supply shocks whose persistence will determine the appropriate policy mix to ensure macroeconomic stabilisation. If the supply shocks are transitory but with demand-side effects, agile fiscal policies, notably targeted and temporary support to vulnerable firms and households in addition to the operation of automatic stabilisers (demand-side component), are appropriate, so long as medium-term fiscal sustainability is ensured. However, if the supply shocks turn out to be of a permanent nature, accommodative macroeconomic policies could ultimately have a destabilising effect. First, they could lead to an increased risk of a price-wage spiral. Second, there would be risks to the achievement of the ECB's inflation target objective, possibly requiring a tightening of monetary policy to keep inflation expectations anchored. Third, they would lead to a further deterioration in governments' budgetary positions.

Measures to support public investment are especially appropriate to address permanent supply shocks. For example, the current array of supply shocks could be addressed by accelerating the green transition, not least as this would mitigate the impact of the energy-related shock, improve the security of energy supply, and reduce the dependency of the EU on fossil fuel imports. The new geopolitical environment will also require major investment in skills and equipment to increase defence capacity in the EU. In contrast to other types of public investment, defence investment is unlikely to significantly improve Member States' fiscal sustainability, given a likely limited impact on potential output. At the same time, positive technology spillovers to the private sector have been observed in the past. While the Russian invasion of Ukraine has revealed new investment priorities for the EU, these should not be allowed to crowd out existing priorities on the green and digital transition.

ANNEX 1
Debt sustainability analysis

A1.1. INTRODUCTION

This annex presents the Commission analysis of fiscal sustainability risks over the short, medium and long term. The analysis uses the Commission's multidimensional framework to assess fiscal sustainability risks.([30]) This includes its debt sustainability analysis (DSA) tool and its standard fiscal sustainability indicators: the S0 indicator (an early-warning indicator of fiscal stress over the short term), the S1 indicator (which measures the fiscal consolidation needed to bring debt to 60% of GDP in 15 years' time) and the S2 indicator (which measures the fiscal effort needed to stabilise the debt-to-GDP ratio over the long term). Over the medium term, the DSA relies on a baseline and several deterministic stress tests and stochastic projections that allow catering for uncertainty around the baseline and deriving an overall debt sustainability risk assessment.

The assessment of the fiscal sustainability is based on the latest available information.([31]) Three inputs are used in the analysis: the Commission 2022 spring forecast and its medium-term extension (in particular, the T+10 GDP projections), the 2022 SCPs and the 2021 Ageing Report.([32]), ([33]) The Ageing Report reflects the projected cost of population ageing over the long term. The medium-term projections based on the Commission 2022 spring forecast incorporate the positive impact of investments on growth under NextGeneration EU (NGEU). The projections do not reflect the expected favourable impact of the structural reforms under the Recovery and Resilience Facility (RRF); yet, these reforms are considered as a mitigating factor in the overall assessment, as they are expected to reduce sustainability risks by strengthening future growth. In line with the 2021 Fiscal Sustainability Report (FSR), the Commission baseline relies on a 'no-fiscal-policy-change' assumption. This implies that structural primary balances (SPBs) (excluding changes in the cost of ageing) remain unchanged as from 2023.

This analysis is then compared with the results of the SCP scenario, to assess whether the full implementation of the SCPs would reduce fiscal sustainability risks. In particular, the SCP scenario assumes that governments i) fully implement the fiscal plans presented in their SCPs until the end of the programme horizon, i.e. until 2025-2026, and ii) sustain their fiscal position beyond the programme horizon (with SPBs remaining unchanged, except for the impact of the cost of ageing).

Table A1.1 summarises the Commission risk classification over the short, medium and long term based on the 2022 spring forecast. The rest of the annex describes more closely the methodology and analysis underpinning this risk classification, starting with the short term (Section A1.2) and moving on to the medium (Section A1.3) and long term (Section A1.4).

([30]) See the 2021 Fiscal Sustainability Report for further details on the methodology: European Commission (2022), 'Fiscal Sustainability Report 2021', *European Economy, Institutional Paper* 171, April 2022, https://ec.europa.eu/info/publications/fiscal-sustainability-report-2021_en.

([31]) 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/files/2022-report-under-article-126-3-treaty-functioning-eu-tfeu_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. The current analysis also fed into dedicated annexes to the 2022 Country reports (https://ec.europa.eu/info/publications/2022-european-semester-country-reports_en) and the statistical annex to the SCP opinions published on 23 May 2022.

([32]) 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.

([33]) The analysis is also based on horizontal assumptions regarding future inflation and interest rate developments in line with the Commission framework to analyse fiscal sustainability risks.

A1.2. SHORT-TERM RISKS

Table A1.1: **Overall fiscal sustainability risk classification based on the Commission 2022 spring forecast**

	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	LOW	HIGH	HIGH	HIGH	HIGH	HIGH	BE
BG	LOW	MEDIUM	LOW	MEDIUM	MEDIUM	MEDIUM	BG
CZ	LOW	MEDIUM	MEDIUM	MEDIUM	HIGH	HIGH	CZ
DK	LOW	LOW	LOW	LOW	LOW	LOW	DK
DE	LOW	LOW (MEDIUM)	LOW (MEDIUM)	LOW	MEDIUM	MEDIUM	DE
EE	LOW	LOW	LOW	LOW	LOW	LOW	EE
IE	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	IE
EL	HIGH	HIGH	HIGH	HIGH	LOW	MEDIUM	EL
ES	LOW	HIGH	HIGH	HIGH	LOW (MEDIUM)	MEDIUM (HIGH)	ES
FR	LOW	HIGH	HIGH	HIGH	LOW	MEDIUM	FR
HR	LOW	MEDIUM (HIGH)	MEDIUM	MEDIUM (HIGH)	LOW	MEDIUM	HR
IT	LOW	HIGH	HIGH	HIGH	LOW (MEDIUM)	MEDIUM (HIGH)	IT
CY	LOW (HIGH)	MEDIUM	LOW (MEDIUM)	MEDIUM	LOW	MEDIUM	CY
LV	LOW	LOW	LOW	LOW	LOW	LOW	LV
LT	LOW	LOW	LOW	LOW	MEDIUM (LOW)	MEDIUM (LOW)	LT
LU	LOW	LOW	LOW	LOW	HIGH	HIGH	LU
HU	LOW	MEDIUM	MEDIUM	MEDIUM	HIGH	HIGH	HU
MT	LOW	MEDIUM (HIGH)	MEDIUM	MEDIUM (HIGH)	HIGH	HIGH	MT
NL	LOW	MEDIUM	MEDIUM	MEDIUM	HIGH (MEDIUM)	HIGH (MEDIUM)	NL
AT	LOW	MEDIUM	MEDIUM	LOW	MEDIUM	MEDIUM	AT
PL	LOW	MEDIUM (LOW)	MEDIUM (LOW)	LOW	MEDIUM	MEDIUM	PL
PT	LOW	HIGH	HIGH	HIGH	LOW	MEDIUM	PT
RO	LOW	HIGH	HIGH	MEDIUM	MEDIUM	MEDIUM	RO
SI	LOW	HIGH	HIGH	MEDIUM (HIGH)	HIGH	HIGH	SI
SK	LOW	HIGH	MEDIUM (HIGH)	HIGH	HIGH	HIGH	SK
FI	LOW	MEDIUM	MEDIUM	LOW	MEDIUM	MEDIUM	FI
SE	LOW	LOW	LOW	LOW	LOW	LOW	SE

Notes: In brackets: risk category in the 2021 Fiscal Sustainability Report, when different.

The S0 indicator informs the early detection of fiscal stress 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 baseline 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 (medium-term) or the S2 (long-term) indicator.

For more information, see the 2021 Fiscal Sustainability Report.

Source: European Commission.

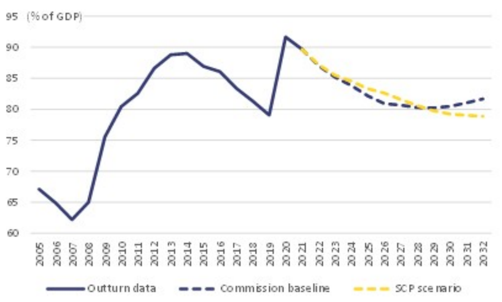
Short-term fiscal sustainability risks have substantially subsided compared with last year thanks to the strong economic recovery in 2021 and decisive policy action. The Commission assesses short-term risks using its standard early-warning indicator S0, which captures both fiscal and macroeconomic vulnerabilities. According to this indicator, the number of countries at risk of fiscal stress in the upcoming year has dropped from 11 at the start of the COVID-crisis (and still 10 countries in spring 2021) to only one country in spring 2022, namely Greece (Table A1.1). This improvement mainly results from the strong economic growth observed in 2021. Moreover, the Eurosystem's asset purchase programmes played a decisive role in preserving favourable financing conditions during the pandemic crisis, and EU initiatives – including NGEU – also sent an important confidence signal to financial markets, lessening risks of short-term fiscal stress. In the case of Greece, a large share of government debt is held by the official sector, also contributing to reducing refinancing risks. In most Member States, governments' gross financing needs, which already declined in 2021 from the peaks recorded in 2020, are expected to diminish further or broadly stabilise in 2022-2023.

A1.3. MEDIUM-TERM RISKS

The Commission 'no-fiscal-policy-change' baseline shows a temporary debt reduction over the 2020s, although with large cross-country differences

For the EU as a whole, the Commission baseline projections point to an initial debt reduction followed by a new increase due to rising ageing costs. General government debt is projected to decline over the 2020s, from close to 90% of GDP in 2021 to 80% in 2029, assuming that the interest-growth differential remains negative (Graph A1.1). Debt would however stabilise and increase again as from 2030 due to increasing pressure from ageing costs. The EU aggregate debt ratio would reach 82% of GDP in 2032. A similar picture emerges for the euro area as a whole: the debt ratio is projected to decline from 97% of GDP in 2021 to around 88% in 2028 before rebounding slightly, also due to ageing costs, reaching 90% of GDP in 2032.

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

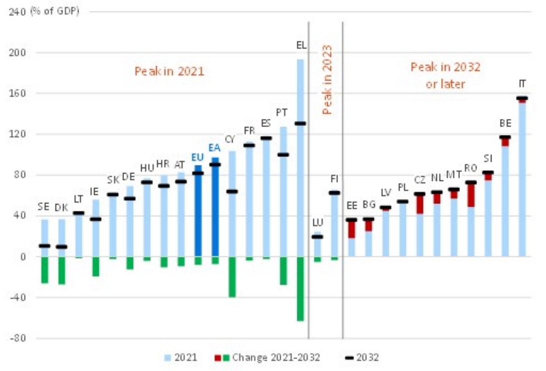


Notes: (1) The Commission baseline assumes that, as from 2023, changes in the SPB only reflect the impact of ageing costs. The SCP scenario assumes that the plans presented in the SCPs are fully implemented and that, beyond the programme horizon, SPBs remain unchanged, except for the impact of the cost of ageing. (2) As France has not yet updated its stability programme due to ongoing elections, the EU aggregate for the SCP scenario includes 'no-fiscal-policy-change' baseline numbers for France.
Source: European Commission.

Large differences across countries exist in terms of debt levels and the timing, magnitude and persistence of the debt reduction. According to the Commission baseline, the debt-to-GDP ratio will remain below its 2021 level until 2032 in 14 Member States and below its 2023 level in two more Member States (Graph A1.2).([34]) In the remaining 11 countries, debt is projected to exceed its 2021 level by 2032. Among those countries, five are projected to see their debt increase steadily over the medium term, although starting from relatively low levels (Bulgaria, Czechia, Estonia, Malta and Romania). In Slovenia, and in Belgium and Italy where debt already stands at a high level, debt would first decline until the mid-2020s and then rise again, reaching, by 2032, the level recorded in 2020 under the Commission "no-fiscal-policy-change" baseline. In Spain and France, the projected debt reduction is very limited, with debt broadly stabilising at a high level, making the trajectory sensitive to adverse shocks. In Greece, despite the strong projected debt reduction, the debt level would remain high; moreover, the projected decline rests on an ambitious fiscal assumption by historical standards.

When factoring in the uncertainty surrounding baseline projections, several countries are found to be at high risk over the medium term based on the Commission analysis

Graph A1.2: **Medium-term debt projections: Commission baseline**

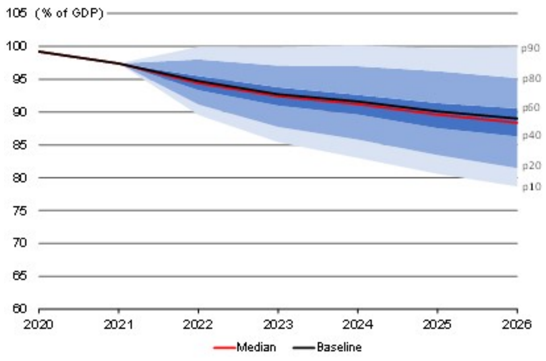


Notes: (1) The countries are ordered first by year of peak, then by debt level at the peak. In case of multiple local peaks, the graph shows the highest one. (2) The Commission baseline assumes that, as from 2023, changes in the SPB only reflect the impact of ageing costs.
Source: European Commission.

The Commission assesses medium-term fiscal sustainability risks based on a comprehensive toolkit which includes the DSA and the S1 indicator. In addition to a baseline, the DSA routinely comprises a set of stress tests and stochastic projections to account for alternative assumptions and a large number of potential shocks. The decision tree, assessment criteria and thresholds used for the DSA risk classification are summarised in Graphs A1.8 and A1.9. The DSA is complemented by the S1 indicator, which assesses the challenges associated with the distance between the current debt level and the Treaty reference value of 60% of GDP.

([34]) In a majority of these countries, however, debt would not steadily decline until 2032 but stabilise or pick up as from the mid- or late 2020s. Debt is projected to decline steadily in Denmark, Greece, Cyprus and Sweden.

Graph A1.3: **Stochastic debt projections, 2022-2026, euro area**



Note: For more information on the methodology, see the 2021 Fiscal Sustainability Report.

Source: European Commission.

The baseline projections are surrounded by a high degree of uncertainty. The stress tests and stochastic projections point to a large degree of uncertainty and vulnerability to shocks. In particular, the stochastic projections suggest a significant (14%) probability that debt in the euro area will be higher in 2026 than it was in 2021 (Graph A1.3). That probability is also particularly large for Belgium, Spain and Italy, given their high debt level, and is combined with high uncertainty around the baseline. Uncertainty is particularly large as well in Greece, Portugal, Bulgaria, Hungary, Cyprus and Romania. Overall, the stress tests and/or the stochastic projections imply a higher risk category than the one derived from the baseline for five countries, namely Bulgaria, Spain, France, Hungary and Slovakia (see Table A1.2).

The DSA, largely confirmed by the S1 indicator, finds that seven countries face high sustainability risks in the medium term. According to the DSA, the countries that face high sustainability risks over the medium term are Belgium, Greece, Spain, France, Italy, Portugal and Slovakia (see Table A1.1 and A1.2). In most of these countries, the results are driven by the high initial debt ratios that are projected to stabilise or decline somewhat only until the mid-2020s before increasing again, approaching if not exceeding the 2021 debt level by 2032. In Greece and Portugal, debt is projected to be on a downward path, but remaining at a high level and assuming fairly ambitious fiscal positions by historical standards. Moreover, an additional nine countries face medium risks according to the DSA, namely Bulgaria, Czechia, Croatia, Cyprus, Hungary, Malta, the Netherlands, Romania and Slovenia, with overall consistent signals across the different scenarios considered. The remaining 11 Member States are classified at low risk. The S1 indicator confirms the DSA results in most cases. However, in few cases, this indicator signals more acute risks: in particular, Romania and Slovenia are found to face high risk according to S1, due to a substantial fiscal effort required to bring the debt-to-GDP ratio to 60% in 15 years' time. Austria, Poland and Finland are classified at medium risk according to the S1 indicator (versus low risk as per the DSA), though Poland and Finland are borderline cases.

Several additional factors may affect fiscal sustainability ([35])

On the upside, many factors contribute to mitigating debt sustainability risks across the EU. One of them is the lengthening of debt maturities in recent years, thanks to which higher market interest rates pass through only slowly to actual interest payments. Other mitigating factors include relatively stable financing sources, with a diversified and large investor base, and still historically low borrowing costs. Moreover, the implementation of the reforms under the NGEU/RRF is expected to have a positive and persistent impact on EU growth, which would strengthen debt sustainability in the coming years.

([35]) The Commission framework considers additional mitigating and aggravating risk factors in the overall assessment, in addition to the risk classification.

Table A1.2: **Detailed medium-term sustainability risk classification based on the Commission 2022 spring forecast**

	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT
S1 indicator in the EU countries												
S1 indicator - Baseline scenario	6.6	-1.2	1.9	-5.9	-0.1	-1.5	-1.5	4.4	5.2	4.6	1.1	9.6
S1 indicator - overall risk assessment	HIGH	LOW	MEDIUM	LOW	LOW	LOW	LOW	HIGH	HIGH	HIGH	MEDIUM	HIGH
Debt sustainability analysis: Sovereign-debt sustainability risks in the EU countries	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT
Baseline no-policy-change scenario	HIGH	LOW	MEDIUM	LOW	LOW	LOW	LOW	HIGH	MEDIUM	MEDIUM	MEDIUM	HIGH
Debt level (2032)	117.1	36.8	61.4	9.7	57.0	36.1	36.7	130.5	116.1	109.0	69.3	155.2
Debt peak year	2032	2032	2032	2021	2021	2032	2021	2021	2021	2021	2021	2032
Average SPB percentile rank (2023-2032)	96%	92%	54%	64%	70%	94%	65%	25%	89%	83%	43%	73%
Historical SPB scenario	MEDIUM	LOW	MEDIUM	LOW	LOW	LOW	LOW	HIGH	MEDIUM	MEDIUM	MEDIUM	HIGH
Debt level (2032)	98.4	22.1	50.2	11.9	44.6	21.1	45.8	121.8	108.0	107.5	70.4	133.9
Debt peak year	2021	2024	2032	2021	2021	2025	2021	2021	2021	2021	2021	2021
Average SPB percentile rank (2023-2032)	84%	76%	33%	68%	40%	72%	75%	22%	72%	82%	48%	44%
Adverse 'r-g' scenario	HIGH	LOW	MEDIUM	LOW	LOW	LOW	LOW	HIGH	HIGH	HIGH	MEDIUM	HIGH
Debt level (2032)	125.4	39.0	65.7	11.3	61.6	38.2	39.3	140.0	125.4	117.4	74.7	168.0
Debt peak year	2032	2032	2032	2021	2021	2032	2021	2021	2032	2032	2021	2032
Average SPB percentile rank (2023-2032)	96%	92%	54%	64%	70%	94%	65%	25%	89%	83%	43%	73%
Financial stress scenario	HIGH	LOW	MEDIUM	LOW	LOW	LOW	LOW	HIGH	HIGH	MEDIUM	MEDIUM	HIGH
Debt level (2032)	118.6	37.0	61.9	9.8	57.5	36.2	36.9	133.7	118.6	111.0	69.8	160.4
Debt peak year	2032	2032	2032	2021	2021	2032	2021	2021	2032	2021	2021	2032
Average SPB percentile rank (2023-2032)	96%	92%	54%	64%	70%	94%	65%	25%	89%	83%	43%	73%
Lower SPB scenario	HIGH	LOW	MEDIUM	LOW	LOW	LOW	LOW	HIGH	HIGH	HIGH	MEDIUM	HIGH
Debt level (2032)	117.7	41.5	70.3	14.9	63.6	37.8	45.9	152.3	119.2	118.2	71.6	160.8
Debt peak year	2032	2032	2032	2021	2021	2032	2021	2021	2032	2032	2021	2032
Average SPB percentile rank (2023-2032)	96%	95%	83%	73%	80%	95%	75%	46%	90%	95%	49%	74%
Stochastic projections	HIGH	MEDIUM	LOW	LOW	LOW	LOW	LOW	MEDIUM	HIGH	LOW	LOW	HIGH
Probability of debt in 2026 > in 2021 (%)	47%	55%	68%	6%	16%	100%	6.7%	8%	41%	23%	9%	36%
Difference 90th-10th percentile in 2026 (pp. GDP)	35.3	50.0	28.0	19.3	25.4	9.9	28.1	59.4	37.7	20.7	26.4	41.7
Debt sustainability analysis - overall risk assessment	HIGH	MEDIUM	MEDIUM	LOW	LOW	LOW	LOW	HIGH	HIGH	HIGH	MEDIUM	HIGH
Overall MEDIUM-TERM risk category	**HIGH**	**MEDIUM**	**MEDIUM**	**LOW**	**LOW**	**LOW**	**LOW**	**HIGH**	**HIGH**	**HIGH**	**MEDIUM**	**HIGH**

	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE
S1 indicator in the EU countries															
S1 indicator - Baseline scenario	-0.4	-0.5	-0.6	-3.5	1.9	1.2	1.9	1.7	0.5	3.7	3.5	4.6	1.8	0.0	-5.7
S1 indicator - overall risk assessment	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	HIGH	HIGH	HIGH	MEDIUM	MEDIUM	LOW
Debt sustainability analysis: Sovereign-debt sustainability risks in the EU countries	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE
Baseline no-policy-change scenario	MEDIUM	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	LOW	LOW	HIGH	MEDIUM	MEDIUM	MEDIUM	LOW	LOW
Debt level (2032)	63.8	48.3	42.7	19.4	72.8	65.9	63.2	73.5	53.9	100.0	72.7	82.5	61.0	62.5	10.5
Debt peak year	2021	2032	2021	2023	2021	2032	2032	2021	2032	2021	2032	2032	2021	2023	2021
Average SPB percentile rank (2023-2032)	35%	77%	56%	83%	66%	78%	100%	91%	81%	41%	75%	90%	38%	92%	60%
Historical SPB scenario	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	HIGH	MEDIUM	LOW	HIGH	LOW	LOW
Debt level (2032)	58.7	44.6	43.8	10.9	64.7	44.4	48.7	66.5	51.6	104.4	64.8	69.8	64.6	52.2	9.9
Debt peak year	2021	2022	2021	2023	2021	2024	2021	2021	2021	2021	2032	2021	2032	2023	2021
Average SPB percentile rank (2023-2032)	30%	69%	59%	73%	58%	51%	85%	71%	78%	50%	73%	62%	44%	67%	60%
Adverse 'r-g' scenario	MEDIUM	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	LOW	LOW	HIGH	MEDIUM	MEDIUM	HIGH	LOW	LOW
Debt level (2032)	68.7	51.9	45.6	20.8	78.8	70.5	67.4	78.9	57.6	108.3	77.6	88.1	64.7	66.6	11.7
Debt peak year	2021	2032	2032	2023	2032	2032	2032	2021	2032	2021	2032	2032	2032	2023	2021
Average SPB percentile rank (2023-2032)	35%	77%	56%	83%	66%	78%	100%	91%	81%	41%	75%	90%	38%	92%	60%
Financial stress scenario	MEDIUM	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	LOW	LOW	HIGH	MEDIUM	MEDIUM	MEDIUM	LOW	LOW
Debt level (2032)	64.1	48.7	43.0	19.5	73.4	66.4	63.5	74.0	54.2	102.0	73.2	82.9	61.4	62.6	10.6
Debt peak year	2021	2032	2021	2023	2021	2032	2032	2021	2032	2021	2032	2032	2021	2023	2021
Average SPB percentile rank (2023-2032)	35%	77%	56%	83%	66%	78%	100%	91%	81%	41%	100%	90%	38%	92%	60%
Lower SPB scenario	MEDIUM	MEDIUM	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	HIGH	MEDIUM	MEDIUM	MEDIUM	LOW	LOW
Debt level (2032)	67.8	66.0	44.3	21.2	85.8	78.9	65.6	85.0	60.2	101.4	77.8	88.3	74.6	65.1	12.3
Debt peak year	2021	2032	2021	2023	2032	2032	2032	2032	2032	2021	2032	2032	2032	2023	2021
Average SPB percentile rank (2023-2032)	37%	90%	60%	86%	72%	90%	100%	95%	88%	44%	80%	94%	54%	93%	66%
Stochastic projections	MEDIUM	LOW	LOW	LOW	MEDIUM	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	LOW	LOW	LOW	LOW
Probability of debt in 2026 > in 2021 (%)	6%	50%	37%	36%	38%	71%	48%	21%	14%	16%	65%	39%	19%	43.9%	0%
Difference 90th-10th percentile in 2026 (pp. GDP)	41.2	31.9	28.7	27.9	44.2	25.7	26.2	31.7	16.5	54.1	40.2	26.1	29.7	23.9	8.5
Debt sustainability analysis - overall risk assessment	MEDIUM	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	LOW	LOW	HIGH	MEDIUM	MEDIUM	HIGH	LOW	LOW
Overall MEDIUM-TERM risk category	**MEDIUM**	**LOW**	**LOW**	**LOW**	**MEDIUM**	**MEDIUM**	**MEDIUM**	**MEDIUM**	**MEDIUM**	**HIGH**	**HIGH**	**HIGH**	**HIGH**	**MEDIUM**	**LOW**

Note: For more information on the methodology, see the 2021 Fiscal Sustainability Report.

Source: European Commission.

On the downside, additional risks could emerge. Some are related to 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 low-interest environment could also weigh on existing vulnerabilities in some countries. In particular, persistently high and volatile inflation may make inflation expectations rise further and translate into higher policy interest rates and inflation risk premia, which would increase borrowing costs, especially in highly indebted countries.

Despite the uncertain economic outlook, the projected debt developments over the medium term have improved somewhat since the autumn 2021

Table A1.3: **Revision of debt projections compared with the 2021 Fiscal Sustainability Report**

(% of GDP)	Debt level in 2023 Spring 2022	Debt level in 2023 2021 FSR	Debt level in 2023 *Diff.*	Debt level in 2032 Spring 2022	Debt level in 2032 2021 FSR	Debt level in 2032 *Diff.*	Change 2023-2032 Spring 2022	Change 2023-2032 2021 FSR
BE	107.6	114.6	*-7.1*	117.1	133.6	*-16.5*	9.5	18.9
BG	25.6	26.8	*-1.2*	36.8	36.4	*0.4*	11.2	9.6
CZ	44.0	46.3	*-2.3*	61.4	67.1	*-5.7*	17.4	20.8
DK	33.9	38.0	*-4.0*	9.7	15.6	*-5.9*	-24.3	-22.4
DE	64.5	68.1	*-3.6*	57.0	61.6	*-4.7*	-7.5	-6.5
EE	23.5	21.4	*2.1*	36.1	25.7	*10.4*	12.7	4.3
IE	45.5	51.1	*-5.6*	36.7	45.7	*-9.0*	-8.8	-5.4
EL	180.4	192.1	*-11.6*	130.5	154.7	*-24.2*	-49.9	-37.3
ES	113.8	116.9	*-3.1*	116.1	126.1	*-10.0*	2.4	9.2
FR	109.1	112.9	*-3.7*	109.0	122.3	*-13.3*	-0.1	9.5
HR	73.1	77.9	*-4.8*	69.3	76.7	*-7.4*	-3.8	-1.2
IT	146.8	151.0	*-4.2*	155.2	161.6	*-6.4*	8.5	10.7
CY	88.8	93.4	*-4.6*	63.8	77.8	*-14.0*	-25.0	-15.5
LV	46.5	49.8	*-3.2*	48.3	48.8	*-0.4*	1.8	-1.0
LT	43.1	46.0	*-2.9*	42.7	39.4	*3.3*	-0.3	-6.5
LU	25.1	25.4	*-0.3*	19.4	18.2	*1.2*	-5.7	-7.2
HU	76.1	76.4	*-0.3*	72.8	68.1	*4.7*	-3.3	-8.3
MT	59.5	63.6	*-4.1*	65.9	73.2	*-7.3*	6.3	9.6
NL	50.9	56.1	*-5.2*	63.2	62.8	*0.4*	12.3	6.7
AT	77.5	77.6	*-0.1*	73.5	76.3	*-2.7*	-4.0	-1.4
PL	49.8	49.5	*0.3*	53.9	48.3	*5.6*	4.1	-1.2
PT	115.3	122.7	*-7.5*	100.0	126.2	*-26.3*	-15.3	3.5
RO	52.6	53.2	*-0.6*	72.7	76.9	*-4.2*	20.2	23.8
SI	72.7	76.0	*-3.4*	82.5	95.2	*-12.7*	9.8	19.2
SK	58.3	59.1	*-0.8*	61.0	72.2	*-11.2*	2.6	13.1
FI	66.6	71.0	*-4.4*	62.5	63.9	*-1.4*	-4.1	-7.1
SE	30.5	31.2	*-0.6*	10.5	11.2	*-0.7*	-20.0	-19.9
EU	**85.2**	**89.1**	***-3.9***	**81.7**	**89.2**	***-7.6***	**-3.5**	**0.2**
EA	**92.7**	**97.0**	***-4.3***	**90.2**	**99.0**	***-8.7***	**-2.5**	**1.9**

Source: European Commission.

Government debt projections have improved in most countries compared with the results from the autumn 2021 as published in the 2021 Fiscal Sustainability Report (FSR). Compared with the 2021 FSR, which was based on the Commission 2021 autumn forecast, the debt ratio projected in the spring 2022 baseline is about 8 pps. of GDP lower for the EU as a whole by 2032, with a lower debt projected for 20 countries (see Table A1.3). The downward revision in the projected debt ratio is particularly large for Portugal (-26 pps. by 2032), Greece (-24 pps.), and Belgium, Cyprus, France, Slovenia and Slovakia (all by more than 10 pps.). Compared with the 2021 FSR, the DSA risk classification has improved for three countries: Croatia, Malta and Slovenia moved from the high-risk to the medium-risk category.

Several factors explain these revisions. These results reflect the better-than-expected budgetary outturn for 2021 (with lower debt levels and higher SPBs in nearly all countries), coupled with the impact of higher inflation which temporarily reinforces the favourable snowball effect before the increase in market interest rates gradually feeds into the effective cost of servicing debt.([36]) These debt-reducing factors are partially offset by a lower growth outlook ([37]) and an increase in public expenditure related to the war in Ukraine, including defence spending, refugee costs, and necessary accompanying measures to cushion the impact of the crisis (such as heightened energy and food prices) and to support energy diversification.([38])

A full implementation of the 2022 SCPs would lead to a steadier debt reduction and reduce risks

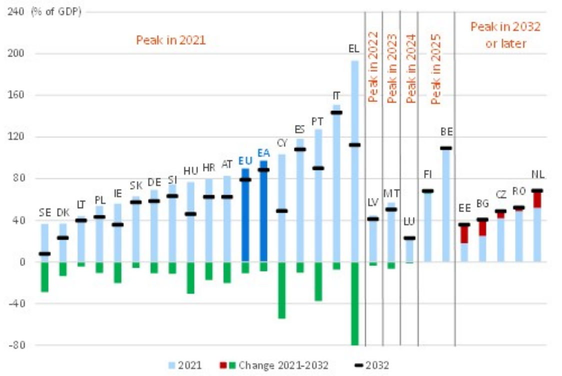
The debt reduction in the EU could be steadier than envisaged in the Commission baseline if the 2022 SCPs were fully implemented, as shown by the SCP scenario. In the mid-2020s, the projected downward path emerging from the SCPs is slightly less steep than in the Commission baseline, as the SCPs assume, on average, a somewhat less favourable interest-growth rate differential than in the baseline (Graph A1.1). However, in the SCP scenario, debt would not pick up at the end of the projection

([36]) By 2032, the nominal implicit interest rate is projected to be higher in the Commission baseline (based on the Commission 2022 spring forecast) than in the 2021 FSR in nearly all Member States.

([37]) Average growth in 2023-2032 is projected to be lower in the Commission baseline (based on the Commission 2022 spring forecast) than in the 2021 FSR in nearly all Member States.

([38]) By 2023, the temporary measures taken in response to the COVID-19 crisis are expected to be completely phased out and the energy-related measures are expected to unwind. The measures related to displaced persons fleeing the war in Ukraine and energy are estimated to amount to around 0.9% of GDP in cumulated terms in 2022-2023.

Graph A1.4: **Medium-term debt projections: SCP scenario**



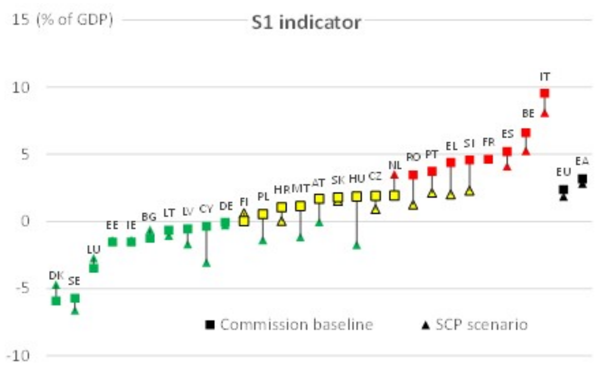
Notes: (1) The countries are ordered first by year of peak, then by debt level at the peak. In case of multiple local peaks, the graph shows the highest one. (2) The SCP scenario assumes that the plans presented in the SCPs are fully implemented and that, beyond the programme horizon, SPBs remain unchanged, except for the impact of the cost of ageing. (3) As France has not yet updated its Stability Programme due to ongoing elections, the EU and euro area aggregates include baseline numbers for France.

Source: European Commission.

period but diminish further to less than 80% of GDP in 2032. Similarly, in the euro area as a whole, the debt ratio would not rebound as in the baseline but broadly stabilise at around 88% of GDP. These results are driven by the continuous improvement of the SPB on aggregate until 2025 in the SCPs, implying that fiscal positions are then maintained at a higher level than in the baseline (which is based on the levels of 2023).

In individual Member States, implementing the plans presented in the SCPs would in most cases strengthen the debt reduction and limit or postpone the later pickup. Compared to the Commission baseline, the SCP scenario points to a reduced number of countries for which debt would be higher in 2032 than in 2021 (Graph A1.4). Overall, the 2032 debt level derived from the SCPs would be lower than in the baseline for most countries, with the exception of 6 Member States (Denmark, Finland, the Netherlands and to a lesser extent Bulgaria, Luxembourg and Germany– in most cases due to a weaker planned fiscal consolidation or a larger fiscal expansion than in the Commission baseline). The planned fiscal consolidation would however not allow to bring the debt trajectory on a steadily declining path in some high debt countries, including Belgium, Italy and Spain, suggesting that these Member States would still face high sustainability risks in the medium term.

Graph A1.5: **S1 indicator and risk categories based on the Commission baseline and the SCP scenario**



Notes: (1) Green: low risk. Yellow: medium risk. Red: high risk.

(2) There is no aggregate risk classification for the EU and the euro area.

(3) 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 (for more information, see the 2021 Fiscal Sustainability Report).

(4) France has not yet updated its Stability Programme due to ongoing elections.

Source: European Commission.

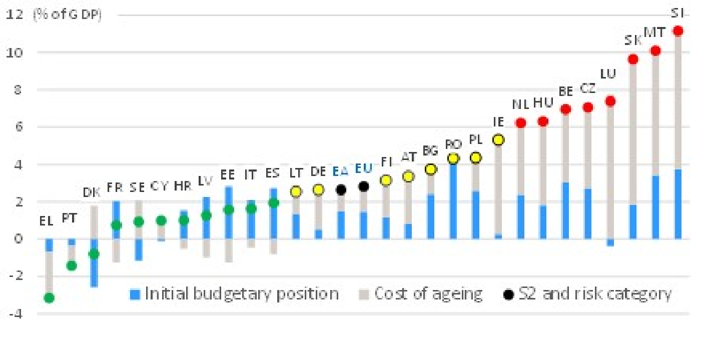
Moreover, in most medium- and high-risk countries, fully implementing the plans presented in the SCPs would alleviate sustainability risks as also captured by the S1 indicator (see Graph A1.5). On this basis, only four countries would face high risks in the medium term, while the S1 indicator based on the Commission baseline identifies eight high-risk countries.

A1.4. LONG-TERM RISKS

Age-related costs are projected to weigh on the long-term sustainability of public finances in a majority of Member States. The Commission's long-term risk classification is based on the S2 indicator and the DSA. The S2 indicator measures the gap with respect to the SPB required to stabilise debt over the long run and includes two components: the initial budgetary position and the cost of ageing. The S2 indicator signals high or medium sustainability risks over the long term in 16 countries

(Graph A1.6). In most of those countries, the risks are mainly attributable to the projected cost of ageing. Notable exceptions are Romania and, to a lesser extent, Bulgaria and Poland, where the initial budgetary position is a larger source of vulnerability.

Graph A1.6: **Breakdown of the S2 indicator, Commission baseline**



Notes: (1) 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. (2) Green markers indicate low risk. Yellow: medium risk. Red: high risk. (3) There is no aggregate risk classification for the EU and the euro area.

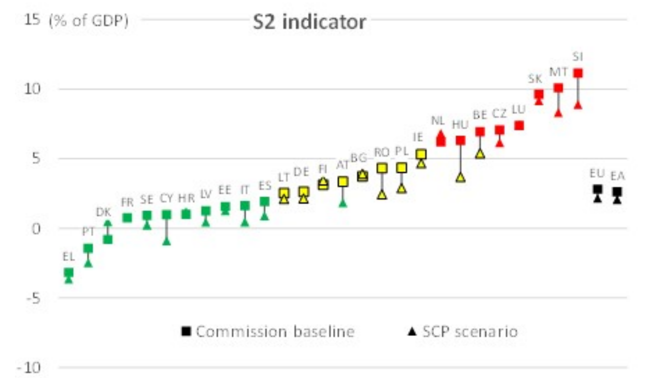
For more information, see the 2021 Fiscal Sustainability Report.

Source: European Commission.

Eight countries face high long-term risks based on the overall long-term risk classification considering both the DSA and the S2 indicator. These are Belgium, Czechia, Luxembourg, Hungary, Malta, the Netherlands, Slovenia and Slovakia. Among the remaining 19 countries, 15 are assessed at medium risk (see Table A1.1). Only four countries (Denmark, Estonia, Latvia and Sweden) appear to be at low risk over the long term.

Compared to the 2021 FSR, the long-term risk classification has changed for four countries. For two of them (Spain and Italy), the classification has improved from high to medium risk, in both cases due to the S2 indicator now pointing to low risk on the back of more favourable initial budgetary positions, while it signalled medium risk based on autumn 2021 projections. This is, however, still coupled with a high-risk signal from the DSA. The two other countries for which the classification has changed are Lithuania (from low to medium risk) and the Netherlands (from medium to high risk), in both cases because less favourable initial budgetary positions have raised the value of S2.

Graph A1.7: **S2 indicator and risk categories based on the Commission baseline and the SCP scenario**



Notes: (1) Green: low risk. Yellow: medium risk. Red: high risk.

(2) There is no aggregate risk classification for the EU and the euro area.

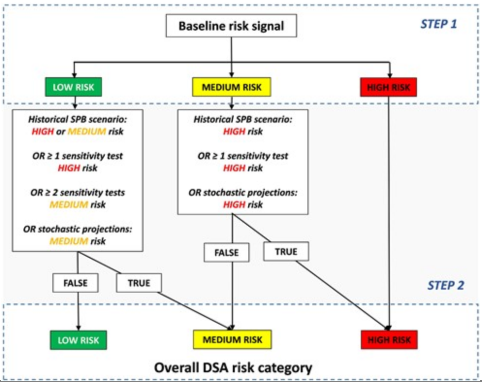
(3) The S2 indicator shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon. (For more information, see the 2021 Fiscal Sustainability Report).

(4) France has not yet updated its Stability Programme due to ongoing elections.

Source: European Commission.

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 A1.7). On this basis, only six countries would face high risks in the long term, while the S2 indicator based on the Commission baseline identifies eight high-risk countries.

Graph A1.8: **Risk classification derived from the debt sustainability analysis: decision tree**



Source: European Commission.

Graph A1.9: **Risk classification derived from the debt sustainability analysis: assessment criteria and thresholds**

Deterministic projections

Case	Debt level	Debt path	Consolidation space	Overall
1	HIGH	HIGH/MEDIUM	ANY	HIGH
2	HIGH	LOW	HIGH/MEDIUM	HIGH
3	HIGH	LOW	LOW	MEDIUM
4	MEDIUM	HIGH	HIGH/MEDIUM	HIGH
5	MEDIUM	HIGH	LOW	MEDIUM
6	MEDIUM	MEDIUM	ANY	MEDIUM
7	MEDIUM	LOW	HIGH/MEDIUM	MEDIUM
8	MEDIUM	LOW	LOW	LOW
9	LOW	HIGH	HIGH/MEDIUM	MEDIUM
10	LOW	HIGH	LOW	LOW
11	LOW	MEDIUM/LOW	ANY	LOW

Stochastic projections

Probability debt not to stabilise	Size of uncertainty	Overall
HIGH	ANY	HIGH
MEDIUM	HIGH	MEDIUM
MEDIUM	MEDIUM	MEDIUM
MEDIUM	LOW	LOW
LOW	HIGH	MEDIUM
LOW	MEDIUM	LOW
LOW	LOW	LOW

Criteria - deterministic projections	*Thresholds*
Debt level (2032)	*High:* above 90% of GDP *Medium:* between 60% of GDP and 90% of GDP *Low:* below 60% of GDP
Debt trajectory (debt peak year)	*High:* peak year between T+7 and end projections (2028-32), or still increasing at end projections *Medium:* peak year between end of forecasts (T+3) and T+6 (2024-27) *Low:* peak year within forecast horizon (2021-23)
Fiscal consolidation space (percentile rank avg SPB 2023-32)	*High:* if smaller than (or equal to) 25% *Medium:* between 25% and 50% *Low:* greater than 50%

Criteria - stochastic projections	*Thresholds*	
Probability of debt not to stabilise over the next 5 years	Initial (2021) debt ratio at or above 90% of GDP:	*High:* if probability above 30% *Medium:* if probability strictly positive and at or below 30% *Low:* if zero probability
	Initial (2021) debt ratio at or above 60% of GDP and below 90% of GDP:	*High:* if probability above 60% *Medium:* if probability between 30% and 60% *Low:* if probability below 30%
	Initial (2021) debt ratio below 60% of GDP:	*Medium:* if probability above 70% *Low:* if probability at or below 70%
Size of macroeconomic uncertainty (difference between the 10th and 90th percentiles of the distribution of debt paths)	*High:* the third of the countries with highest dispersion *Medium:* the third of the countries with intermediate dispersion *Low:* the third of the countries with lowest dispersion	

Source: European Commission.

ANNEX 2
Key macro-fiscal indicators

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

	2022 Stability and Convergence Programmes				2022 Spring forecast			Difference compared to forecast (red means higher in programme)	
	2022	2023	2024	2025	2021	2022	2023	2022	2023
BE	108.0	108.8	109.7	110.1	108.2	107.5	107.6	0.5	1.2
CY	93.9	88.2	81.0	76.7	103.6	93.9	88.8	0.0	-0.6
DE	66.8	65.8	65.6	65.0	69.3	66.4	64.5	0.4	1.3
EE	20.7	24.1	27.7	29.2	18.1	20.9	23.5	-0.2	0.6
EL	180.2	168.6	155.2	146.5	193.3	185.7	180.4	-5.5	-11.8
IE	50.1	46.3	43.8	40.7	56.0	50.3	45.5	-0.2	0.8
ES	115.2	112.4	110.9	109.7	118.4	115.1	113.7	0.1	-1.3
IT	147.0	145.2	143.4	141.4	150.8	147.9	146.8	-0.9	-1.6
LV	45.7	45.2	44.5	43.4	44.8	47.0	46.5	-1.3	-1.3
LT	43.3	43.7	42.6	42.5	44.3	42.7	43.1	0.6	0.6
LU	25.4	25.8	26.2	26.2	24.4	24.7	25.1	0.7	0.7
MT	58.6	59.4	58.6	57.2	57.0	58.5	59.5	0.1	-0.1
NL	53.1	52.7	53.1	54.4	52.1	51.4	50.9	1.7	1.8
AT	80.0	77.1	74.5	72.1	82.8	80.0	77.5	-0.1	-0.4
PT	120.8	115.4	109.8	105.9	127.4	119.9	115.3	0.8	0.2
SI	73.3	71.5	69.5	68.0	74.7	74.1	72.7	-0.8	-1.2
SK	61.6	58.0	58.2	57.3	63.1	61.7	58.3	-0.1	-0.3
FI	66.2	66.9	68.0	69.1	65.8	65.9	66.6	0.3	0.3
BG	25.5	27.7	29.1	30.4	25.1	25.3	25.6	0.2	2.1
CZ	42.7	43.4	44.4	45.4	41.9	42.8	44.0	-0.1	-0.6
DK	33.3	32.5	34.0	33.9	36.7	34.9	33.9	-1.6	-1.4
HR	76.2	71.7	68.9	66.9	79.8	75.3	73.1	0.9	-1.4
HU	76.1	73.8	70.4	66.9	76.8	76.4	76.1	-0.3	-2.3
RO	49.4	49.7	49.4	48.9	48.8	50.9	52.6	-1.5	-2.9
PL	52.1	51.5	51.0	49.7	53.8	50.8	49.8	1.3	1.7
SE	33.5	30.7	28.9	26.4	36.7	33.8	30.5	-0.3	0.2
EA	90.7	89.0	87.7	86.9	93.5	90.5	88.7	0.2	0.3
EU	82.2	80.5	79.3	78.6	84.9	82.1	80.4	0.1	0.2

Note: the EU and EA aggregates do not include France

Source: European Commission Spring forecast and 2022 SCPs.

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

	2022 Stability and Convergence Programmes				2022Spring forecast			Difference compared to forecast (red means higher in programme)	
	2022	2023	2024	2025	2021	2022	2023	2022	2023
BE	-5.2	-3.6	-3.4	-2.7	-5.5	-5.0	-4.4	-0.3	0.9
CY	0.0	0.4	1.5	1.7	-1.7	-0.3	-0.2	0.3	0.6
DE	-3.7	-1.9	-1.8	-0.9	-3.7	-2.5	-1.0	-1.2	-0.9
EE	-5.3	-4.8	-3.8	-2.9	-2.4	-4.4	-3.7	-0.9	-1.1
EL	-4.4	-1.4	-0.4	-0.1	-7.4	-4.3	-1.0	-0.1	-0.4
IE	-0.4	0.2	1.2	1.4	-1.9	-0.5	0.4	0.1	-0.2
ES	-5.0	-3.9	-3.3	-2.9	-6.9	-4.9	-4.4	-0.1	0.5
IT	-5.1	-3.7	-3.2	-2.7	-7.2	-5.5	-4.3	0.4	0.6
LV	-6.5	-2.8	-2.3	-1.7	-7.3	-7.2	-3.0	0.7	0.2
LT	-4.9	-2.4	-1.3	-1.0	-1.0	-4.6	-2.3	-0.3	-0.1
LU	-0.7	-0.4	-0.3	-0.2	0.9	-0.1	0.1	-0.6	-0.5
MT	-5.4	-4.6	-2.8	-2.4	-8.0	-5.6	-4.6	0.2	0.0
NL	-2.5	-2.3	-2.5	-2.9	-2.5	-2.7	-2.1	0.2	-0.2
AT	-3.1	-1.5	-0.7	-0.3	-5.9	-3.1	-1.5	0.0	0.0
PT	-1.9	-0.7	-0.3	0.0	-2.8	-1.9	-1.0	0.0	0.4
SI	-4.1	-3.0	-2.1	-1.7	-5.2	-4.3	-3.4	0.3	0.4
SK	-5.1	-2.4	-2.3	-2.0	-6.2	-3.6	-2.6	-1.4	0.2
FI	-2.2	-1.7	-1.4	-1.8	-2.6	-2.2	-1.7	0.0	0.0
BG	-5.3	-2.9	-2.8	-2.4	-4.1	-3.7	-2.4	-1.6	-0.5
CZ	-4.5	-3.2	-2.9	-2.7	-5.9	-4.3	-3.9	-0.2	0.7
DK	0.6	0.2	0.6	0.4	2.3	0.9	0.6	-0.3	-0.4
HR	-2.8	-1.6	-1.6	-1.2	-2.9	-2.3	-1.8	-0.6	0.2
HU	-4.9	-3.5	-2.5	-1.5	-6.8	-6.0	-4.9	1.1	1.4
RO	-6.2	-4.4	-3.0	-2.9	-7.1	-7.5	-6.3	1.3	1.9
PL	-4.3	-3.7	-3.1	-2.5	-1.9	-4.0	-4.4	-0.3	0.7
SE	-0.5	0.7	0.8	1.4	-0.2	-0.5	0.5	0.0	0.2
EA	-3.9	-2.5	-2.1	-1.6	-4.8	-3.5	-2.3	-0.4	-0.2
EU	-3.7	-2.4	-2.0	-1.5	-4.3	-3.4	-2.4	-0.3	0.0

Note: the EU and EA aggregates do not include France

Source: European Commission Spring forecast and 2022 SCPs.

Table A2.3: Real GDP growth

	2022 Stability and Convergence Programmes				2022Spring forecast			Difference compared to forecast (red means higher in programme)	
	2022	2023	2024	2025	2021	2022	2023	2022	2023
BE	3.0	1.9	1.5	1.3	6.2	2.0	1.8	1.0	0.1
CY	2.7	3.8	3.4	3.0	5.5	2.3	3.5	0.4	0.3
DE	3.6	2.3	0.8	0.8	2.9	1.6	2.4	2.1	-0.1
EE	-1.0	1.2	3.2	2.6	8.3	1.0	2.4	-2.0	-1.2
EL	3.1	4.8	3.5	3.3	8.3	3.5	3.1	-0.4	1.7
IE	6.4	4.4	4.0	3.8	13.5	5.4	4.4	1.0	0.0
ES	4.3	3.5	2.4	1.8	5.1	4.0	3.4	0.3	0.1
IT	3.1	2.4	1.8	1.5	6.6	2.4	1.9	0.7	0.5
LV	2.1	2.5	3.3	3.4	4.5	2.0	2.9	0.1	-0.4
LT	1.6	2.5	3.0	3.0	5.0	1.7	2.6	-0.1	-0.1
LU	1.4	2.9	2.9	2.6	6.9	2.2	2.7	-0.8	0.2
MT	4.4	3.9	3.7	3.5	9.4	4.2	4.0	0.2	-0.1
NL	3.6	1.7	2.0	1.7	5.0	3.3	1.6	0.3	0.1
AT	3.9	2.0	1.8	1.6	4.5	3.9	1.9	0.0	0.1
PT	5.0	3.3	2.6	2.6	4.9	5.8	2.7	-0.8	0.6
SI	4.2	3.0	2.8	2.6	8.1	3.7	3.1	0.5	-0.1
SK	2.1	5.3	1.8	1.8	3.0	2.3	3.6	-0.2	1.7
FI	1.5	1.7	1.5	1.3	3.5	1.6	1.7	-0.1	0.0
BG	2.6	2.8	3.6	3.4	4.2	2.1	3.1	0.5	-0.3
CZ	1.2	3.6	3.2	2.4	3.3	1.9	2.7	-0.7	0.9
DK	3.4	1.9	1.2	0.6	4.7	2.6	1.8	0.8	0.1
HR	3.0	4.4	2.7	2.5	10.2	3.4	3.0	-0.4	1.5
HU	4.3	4.1	4.2	4.3	7.1	3.6	2.6	0.7	1.5
RO	2.9	4.4	4.8	4.5	5.9	2.6	3.6	0.3	0.8
PL	3.8	3.2	3.0	3.1	5.9	3.7	3.0	0.1	0.2
SE	3.1	1.6	1.6	1.7	4.8	2.3	1.4	0.8	0.2
EA	3.6	2.6	1.7	1.5	5.0	2.6	2.4	1.0	0.2
EU	3.5	2.6	1.9	1.7	5.1	2.7	2.4	0.9	0.2

Note: the EU and EA aggregates do not include France

Source: European Commission Spring forecast and 2022 SCPs.

Table A2.4: Emergency temporary measures (% of GDP)

	2020	2021	2022
BE	4.4	2.9	0.4
CY	3.6	3.0	0.4
DE	2.7	4.2	1.2
EE	2.3	2.7	0.8
EL	7.6	7.2	1.8
IE	3.3	2.7	0.6
ES	3.9	2.8	0.4
FR	3.3	2.6	0.4
IT	4.4	3.5	1.1
LV	2.8	5.2	0.8
LT	3.9	2.8	1.2
LU	2.4	0.7	0.1
MT	6.3	4.7	1.3
NL	3.3	3.3	0.9
AT	4.8	4.3	1.1
PT	2.3	2.2	0.7
SI	5.1	3.8	0.5
SK	2.3	3.3	1.0
FI	2.8	1.7	0.2
BG	2.9	4.3	1.8
CZ	3.1	2.3	0.1
DK	2.6	4.0	0.0
HR	3.4	2.1	0.4
HU	4.0	0.8	0.0
RO	1.7	0.9	0.0
PL	4.5	2.7	0.0
SE	3.3	2.2	1.2

Source: European Commission 2022 Spring forecast.

Glossary

Automatic stabilisers Features of the government budget that react automatically 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 impact 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*.

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 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 adjustment A permanent change in the fiscal position of the government. The *expenditure benchmark* is the main indicator used to measure the fiscal adjustment 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 fiscal adjustment in the national budget is therefore calculated as follows:

$$Fiscal\ adjustment_t = \frac{(1 + Pot_t) * (1 + \pi_t) * E_{t-1}^{FA} - E_t^{FA} + \Delta RM_t}{Y_t}$$

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:

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

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.

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 *NextGenerationEU* and its *Recovery and Resilience Facility)*. 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, 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.

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.

Non-emergency measures Fiscal measures introduced since March 2020 that are not classified either as COVID-19 emergency measures, or as recovery support measures, funded by RRF grants, or as energy measures. These measures include recovery support measures financed by national budget.

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. 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.

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.

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