PART II

SPECIAL ISSUES

II.1. THE DSA METHODOLOGY IN THE NEW ECONOMIC GOVERNANCE FRAMEWORK

This chapter presents the role of the debt sustainability analysis (DSA) in the new EU fiscal framework, following the recent provisional agreement between the Council and the European Parliament to reform the Stability and Growth Pact ([97])**.** To ensure transparency and replicability, the chapter describes how the DSA methodology is applied in the context of the new rules, and it includes illustrative examples for fictitious countries ([98]).

II.1.1. A GREATER ROLE FOR DEBT SUSTAINABILITY IN THE FISCAL RULES

The new EU fiscal framework places each country's debt sustainability challenges at the core of the rules. One of the main reasons for revising the EU fiscal framework was that the former rules were not sufficiently differentiated across countries and did not account well for fiscal sustainability risks ([99]). The new medium-term approach allows fiscal surveillance to move towards a more risk-based framework, in which the required adjustment is country-specific and directly anchored on debt sustainability. In particular, high debt needs to be gradually reduced at a pace that reflects not only the country's initial debt level but also economic growth prospects and future budgetary burdens, such as ageing-related expenditure and interest payments.

At the same time, the framework remains transparent, common to all EU Member States, and consistent with the Treaty reference values for the debt and deficit ratios. The framework keeps its anchoring on the 60% of GDP reference value for debt, and 3% of GDP reference value for the deficit. For countries with debt above 60% of GDP or a deficit above 3% of GDP, policy action is needed to ensure that debt plausibly declines or stays at prudent levels (below 60% of GDP) over the medium term. Similarly, the deficit needs to be brought and maintained below 3% of GDP. For those countries with debt below 60% of GDP and a deficit below 3% of GDP, fiscal policy needs to ensure that these reference values are not breached over the medium term. In the new framework, the European Commission will provide technical guidance to the Member States, in the form of reference trajectories or technical information. This technical guidance will be based on the DSA, and consistent with a number of safeguards ([100]).

II.1.2. THE DSA-BASED METHODOLOGY USED TO ASSESS THE DEBT AND DEFICIT DYNAMICS OVER THE MEDIUM TERM IN THE EU FISCAL FRAMEWORK

In the context of the new framework, the Commission uses a methodology that largely draws on the standard DSA approach, but with slight adjustments to fit the specific aim of budgetary planning. As in the standard DSA, the approach consists in projecting debt over the medium term under a (no-fiscal-policy-change) baseline and applying deterministic and stochastic stress tests around it. However, the scope differs. While the standard DSA takes the initial structural primary balance (SPB) as given and assesses risks to debt sustainability if no additional fiscal policy measures are taken, the objective within

([97]) The regulations to which this chapter refers are those of the provisional political agreement of 10 February 2024 and are available at https://www.consilium.europa.eu/en/press/press-releases/2024/02/10/economic-governance-review-council-and-parliament-strike-deal-on-reform-of-fiscal-rules/.

([98]) This methodology applies for the preparation of the first medium-term plans in 2024. In the future, a working group for debt sustainability analysis will be set up and explore possible methodological improvements, including on underlying assumptions. This working group should be composed of national experts, the Commission and the European Central Bank. The European Fiscal Board and the European Stability Mechanism should be invited by the working group as observers. Moreover, the competent committee of the European Parliament may invite the Commission to present its methodology (see Recital 14c in the agreed preventive arm regulation, see footnote 1).

([99]) See Orseau, E., H. Van Noten, P. Arevalo, A. Cepparulo, G. Mourre and S. Pamies (2023), 'How to ensure fiscal sustainability in a growth-friendly manner?', *Quarterly Report on the Euro Area*, Directorate General Economic and Financial Affairs (DG ECFIN), European Commission, 21(4): 13-24, February.

([100]) The relevant articles of the agreed preventive arm regulation (see footnote 1) are Articles 5, 6, 6a, 6b and 7 for the technical guidance, Article 8 for the assessment of plausibility and Article 15 for the criteria to assess the plans.

the new EU fiscal surveillance context is to check whether a chosen fiscal adjustment path effectively leads to a declining or sufficiently low debt, even under adverse conditions. This assessment applies twice: once when the Commission calculates the reference trajectories to be provided to Member States for guidance, and once when it assesses the adjustment paths put forward by Member States in their own plans. This new approach calls for three methodological adaptations compared with the standard DSA. First, the time horizon is shifted, as the 10-year no-fiscal-policy-change assumption and the stress tests start only after the end of the adjustment period. Second, the 'lower SPB' scenario applies an exogenous shock on the SPB rather than one that depends on the planned adjustment. If the shock on the SPB depended on the planned adjustment, a larger adjustment would imply a larger shock and therefore require an even larger adjustment. To avoid this circularity effect, the shock is exogenously set to a fixed amount. Finally, the 'historical SPB' scenario of the standard DSA, which assesses the risks linked to reverting to past fiscal behaviour, is dropped as it is not relevant in a context of Member States setting (and committing to) adjustment paths.

II.1.3. THE ADJUSTMENT SCENARIO

The adjustment scenario starts with an adjustment period followed by a 10-year no-fiscal-policy-change period. While there are similarities with the standard DSA baseline, by design, the assumptions during the adjustment period differ from it.

- ***Fiscal policy:*** For the first plans, the adjustment starts in 2025, taking the fiscal position in 2024 as the initial level. During the adjustment period, a linear fiscal adjustment is assumed to compute the DSA-based requirements, although this linear profile can possibly be modified once the benchmark and safeguards are applied (see below). When computing the reference trajectories, the Commission does not make any particular assumptions on whether the adjustment comes from changes in primary expenditure or discretionary revenue measures. Beyond the adjustment period, a no-fiscal-policy-change assumption applies, with primary expenditure being only modified by changes in the cost of ageing as projected in the forthcoming 2024 Ageing Report jointly prepared by the EPC Ageing Working Group and the Commission, and with revenue remaining broadly stable as a share of GDP.

- ***GDP growth*** relies on the 'T+10 projections' based on the EU commonly agreed methodology within the Output Gap Working Group of the Economic Policy Committee, minus the feedback effect of fiscal adjustment on GDP growth via a standard fiscal multiplier of 0.75, and with the output gap closing over 3 years after the end of adjustment. Beyond the first 10 years, the macroeconomic projections of the forthcoming 2024 Ageing Report are used.

The remaining assumptions are in line with the standard DSA:

- ***Market interest rates*** and ***inflation*** are assumed to converge over a 10-year horizon to country-specific values reflecting financial markets' expectations. Beyond this horizon, they further converge over a long horizon to common values in line with the latest Ageing Report for interest rates and with the monetary policy targets for inflation.

- ***Stock-flow adjustments*** are in line with the Commission forecast up to T+2 and set to zero afterwards, except for some specific cases reflecting the building-up of public pension funds and interest deferrals on official loans. This currently applies to Luxembourg, Finland and Greece.

II.1.4. DETERMINISTIC STRESS TESTS

To account for macroeconomic uncertainty and ensure that debt plausibly declines even under more adverse assumptions, three stress tests are applied around the adjustment scenario. All three stress tests apply as from the first year after the adjustment period and are largely similar to the standard DSA stress tests (as described in Box I.2.1).

- ***'Lower SPB' scenario:*** the SPB is assumed to be reduced by 0.5 pp. of GDP in total, with a reduction of 0.25 pp. each year over the first two years, and to remain at that level afterwards, plus changes in the cost of ageing. The 0.5 pp. shock corresponds to half of the historical standard deviation of the SPB over all EU countries ([101]);

- ***'Adverse r-g' scenario:*** the interest/growth-rate differential is assumed to be permanently increased by 1 pp. over the projection horizon;

- ***'Financial stress' scenario:*** market interest rates are assumed to temporarily increase for one year by 1 pp., plus a risk premium for high-debt countries ([102]).

II.1.5. STOCHASTIC ANALYSIS

In line with the standard DSA, stochastic simulations are applied around the adjustment scenario to account for wide-ranging uncertainty. The 10 000 shocks affecting governments' budgetary positions, economic growth, interest rates and exchange rates are generated based on the historical distribution of shocks of each country (see Annex A4).

II.1.6. DSA-BASED CRITERIA

The reference trajectories and Member States' plans need to ensure that, without further adjustment, three criteria are met:

1. By the end of the adjustment period at the latest, and over the 10 following years, debt declines or stays below 60% of GDP both in the adjustment scenario and under all three deterministic stress tests;

2. In the 5 years following the adjustment period, debt declines with a sufficiently high probability, i.e. at least 70%, in line with the threshold used in the Commission's standard DSA;

3. The deficit is brought and remains below 3% of GDP over the medium term.

In case a smaller adjustment than the one implied by the first two criteria is sufficient to ensure that debt is brought or remains below 60% of GDP under both the adjustment scenario and all deterministic stress tests while ensuring that the third criterion is met, then that smaller, 'eased-up' adjustment is chosen.

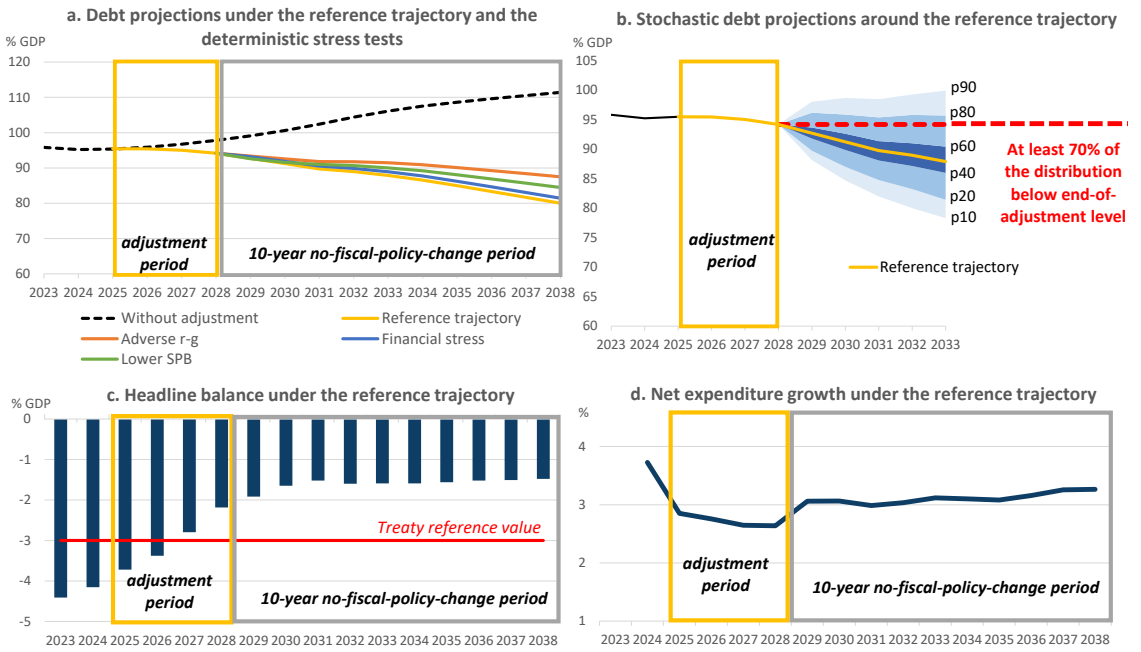
([101]) It is also in line with the IMF's "Staff guidance note for public debt sustainability analysis for market-access countries" of May 2013.

([102]) Pamies, S., Carnot, N., and Patarau, A. (2021), "Do fundamentals explain differences between Euro Area sovereign interest rates?", European Economy — Discussion Paper, No 141, June. See also the European Commission's Fiscal Sustainability Report 2021.

II.1.7. ILLUSTRATION: AN EXAMPLE OF PLAUSIBLE DECLINE IN DEBT

The graphs below illustrate the case of an adjustment complying with the three criteria above for a fictitious country where initially debt exceeds 60% of GDP and the deficit exceeds 3% of GDP, and assuming a 4-year adjustment period. In the absence of any new fiscal measures, the SPB would remain at its 2024 level plus changes in the cost of ageing, and debt would keep increasing over the medium term (dashed line in Graph II.1.1a). The adjustment in the plan needs to be such that, by 2028 at the latest, debt declines not only under the adjustment scenario (yellow line) but also under the three adverse stress tests. Moreover, by 2033, at least 70% of the debt distribution obtained with stochastic simulations needs to stand below the 2028 debt level (Graph II.1.1b). Such an adjustment also complies with criterion (3) (Graph II.1.1c). Graph II.1.1d reports the associated path in terms of nominal net expenditure growth.

Graph II.1.1: **DSA-based criteria in the reference trajectory: an illustrative example**



Source: Commission services.

II.1.8. BENCHMARK AND SAFEGUARDS

In the new framework, three provisions need to be fulfilled in addition to the DSA-based criteria:

- The ***'deficit benchmark'*** (Art. 6(d) of the preventive arm regulation ([103])) ensures consistency with the corrective path referred to in Article [X] of Council Regulation (EC) No 1467/97, where applicable. In the simulations, it is applied by requesting a minimum annual adjustment of 0.5 pp. of GDP if the deficit exceeded 3% of GDP in the previous year. This adjustment is measured in terms of structural balance as from 2028 but, over the transition period of 2025-2027, it is applied in structural primary terms. This is in line with Recital 24 bis of the agreed corrective arm regulation.

([103]) See footnote 1.

- The ***'debt sustainability safeguard'*** (Art. 6a) requires debt to decline on average by at least 1 pp. of GDP per year as long as debt exceeds 90% of GDP, and by at least 0.5 pp. of GDP per year as long as debt stands between 60% and 90% of GDP. The average decrease is calculated from the year before the start of the adjustment period or from the year in which the excessive deficit procedure is projected to be abrogated under Council Regulation (EC) No 1467/97, whichever occurs last, until the end of the adjustment period. In the simulations, the year of abrogation of the excessive deficit procedure is interpreted as the year after the deficit comes below 3% of GDP.

- The ***'deficit resilience safeguard'*** (Art. 6b) requires an adjustment of at least 0.4 pp of GDP (0.25 pp. in case of extension) in structural primary terms until the structural balance is above or equal to -1.5% of GDP.

Unlike the debt sustainability safeguard, the deficit benchmark and the deficit resilience safeguard are applied year by year. They may therefore lead to nonlinear adjustment profiles. The principle of not backloading the effort is met by construction, except for the impact of the end of the transitory period for the deficit benchmark (see Case 2 in Table II.1.1). Moreover, the benchmark and safeguards can only be *added* to the DSA-based requirements when they are binding and cannot *reduce* the DSA-based requirements. Table II.1.1 provides some fictitious examples of cases when the adjustment complying with the DSA-based criteria would not be sufficient to fulfil all additional provisions.

Table II.1.1: **Examples of application of the benchmark and safeguards: impact on the annual adjustment requirements**

Case 1: Debt exceeds 90% of GDP and declines by less than 1pp. of GDP on average				
DSA-based criteria only	DSA-based criteria + benchmark and safeguards			
	2025	2026	2027	2028
0.70	**0.80**	**0.80**	**0.80**	**0.80**

Case 2: The headline deficit exceeds 3% of GDP for 4 years				
DSA-based criteria only	DSA-based criteria + benchmark and safeguards			
	2025	2026	2027	2028
0.45	**0.50**	**0.50**	**0.50**	0.64

Case 3: The structural deficit exceeds 1.5% of GDP during the projection period				
DSA-based criteria only	DSA-based criteria + benchmark and safeguards			
	2025	2026	2027	2028
0.30	*0.40*	*0.40*	0.30	0.30

Notes: (1) The adjustment is in terms of change in SPB as a percentage of GDP.
(2) The colour code is as follows: black normal: requirements complying with the DSA-based criteria; red bold: the deficit benchmark as measured in terms of change in the structural primary balance is binding; yellow background: the deficit benchmark as measured in terms of change in the structural balance is binding; black bold: the debt sustainability safeguard is binding; blue italics: the deficit resilience safeguard is binding.
(3) Case 1: with the DSA-based requirements, debt would decline but not at the pace implied by the debt sustainability safeguard. The safeguard implies an additional 0.1 pp. of GDP annual adjustment throughout the adjustment period.
(4) Case 2: as it takes 4 years to bring the deficit below 3% of GDP, the deficit benchmark applies first in structural primary terms in 2025-2027 and then in structural terms in 2028 (implying a higher adjustment given the projected increase in interest expenditure).
(5) Case 3: the DSA-based requirement would not be sufficient to reduce the structural deficit below 1.5% of GDP; the deficit resilience safeguard is therefore binding until it is the case.
Source: Commission services.

II.1.9. EQUIVALENCE BETWEEN REQUIREMENTS IN TERMS OF NET EXPENDITURE GROWTH AND SPB

As the Commission's debt projection model is based on the SPB and some articles of the regulation refer to this metric (in particular, Art. 6b), the reference trajectories are computed in terms of change in SPB and translated in terms of net primary expenditure growth. This is done using the standard formula below, as already used in the EU fiscal rules:

Nominal net primary expenditure growth = (yearly) potential GDP growth + inflation (as measured by the GDP deflator) – required change in the SPB / primary expenditure-to-GDP ratio

The formula to express requirements in terms of net expenditure growth uses yearly potential growth. Under the previous EU fiscal rules, the expenditure benchmark was computed using a 10-year moving average for potential growth, centred on the year under consideration; that was meant to ensure that fiscal requirements for that year rested on a relatively stable growth assumption. In the new framework, using a moving average is no longer necessary or relevant, for three reasons. *First*, the reference trajectories are computed based on projections over a horizon of 14 or 17 years, incorporating de facto some form of medium-term growth average. *Second*, using yearly potential growth ensures consistency with the DSA framework where, in the absence of fiscal effort, the SPB is held constant as a share of yearly potential GDP. This is translated into net expenditure growth evolving in line with yearly potential growth. Similarly, the year-by-year application of the benchmark and safeguards in terms of SPB needs to be matched by a yearly profile for net expenditure growth, using yearly potential growth in line with the SPB. *Third*, with annual potential growth, the time window for growth can be exactly aligned with the relevant projection period, while a 10-year moving average would include 5 years of past potential growth. Those past years, going back to the years of the COVID-19 crisis and the subsequent recovery, would unduly affect the requirements in the first years of the plans.

II.1.10.TECHNICAL INFORMATION

Technical information regards those Member States for which both the deficit and debt already stand below the Treaty reference values. For these countries, the information provided by the Commission, if requested by the Member State, is the SPB level ensuring that (in line with Art. 7.2 and Art. 15):

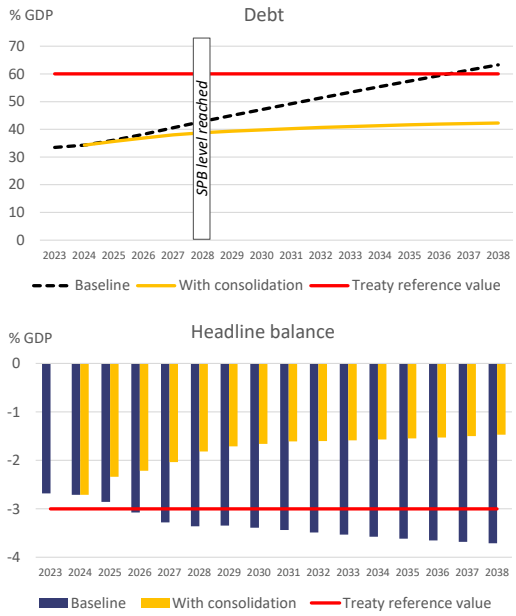
1. The headline deficit is maintained below 3% of GDP during the adjustment period (if any) and over a subsequent 10-year no-fiscal-policy-change period;

2. Debt is maintained below 60% of GDP during the adjustment period (if any) and over a subsequent 10-year no-fiscal-policy-change period;

3. The deficit resilience safeguard is fulfilled.

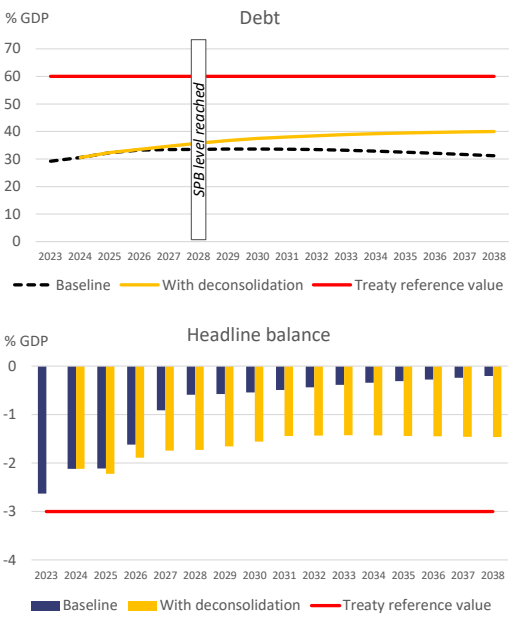
The graphs below provide illustrative examples. Graphs II.1.2 and II.1.3 illustrate, respectively, the case of a country that needs to improve its SPB to maintain its debt and deficit below the Treaty reference values and the case of a country that can deconsolidate to some extent while maintaining its debt and deficit below the Treaty reference values. In both cases, the headline deficit (which is equal to the structural deficit once the output gap has closed) is projected to reach a value slightly below 1.5% of GDP, in line with the deficit resilience safeguard.

Graph II.1.2: **Technical information: case of a country consolidating to remain below the Treaty reference values**



Source: Commission services

Graph II.1.3: **Technical information: case of a country expanding while remaining below the Treaty reference values**



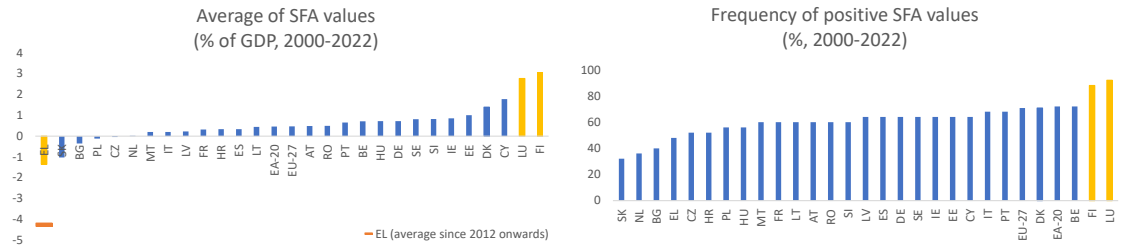
Source: Commission services.

II.2. THE REVISED STOCK-FLOW ADJUSTMENT (SFA) ASSUMPTIONS

II.2.1. RATIONALE FOR REVISING THE SFA ASSUMPTION

This chapter presents the revised standard assumption on stock-flow adjustment (SFA) used in this report. Until the DSM 2022, SFA were assumed to be equal to zero beyond the short-term (T+2) forecast for all Member States, with the exception of Greece. In the latter case, interest deferrals linked to EFSF loans justified a non-zero assumption over the medium-term projection period. As defined by Eurostat, a zero SFA value corresponds to a situation where the change in debt equals the budget balance. Consequently, a negative (positive) value of SFA is associated with a change in debt that is smaller (larger) than what is implied by the deficit (or decreases more (less) than implied by the surplus). SFA combine a wide range of sub-items, each prone to be affected by various events, and therefore are difficult to project over the medium and long term. ([104]) In most countries, SFA values appear highly volatile over time, with no clear tendency to be either systematically positive or negative. ([105]) Hence, for medium and long-term projections, a zero SFA assumption appears generally reasonable, and is in line with other institutions' practices. In some Member States, however, significant and persistent non-zero SFAs values have been observed in the past. For instance, *significant and persistent positive* SFA values are observed in Finland and Luxembourg, *while significant and recurrent negative* SFA values are also noted in the case of Greece (Graph II.2.1).

Graph II.2.1: **Historical stylised facts in SFAs across EU Member States**



Source: Commission services (AMECO).

II.2.2. HORIZONTAL CRITERIA USED IN THE REVISED SFA ASSUMPTION AND COUNTRIES CONCERNED ([106])

An adjustment of the standard SFA assumption in the DSA is warranted in case Member States fulfil three well-defined horizontal criteria. In cases where (i) SFAs have been *persistently and significantly* different from zero, (ii) such patterns can be explained by *structural factors*, and (iii) it is reasonably possible to project SFA based on *reliable and predictable* information, the SFA assumption is adjusted to more realistically reflect past and future developments. Based on these horizontal criteria, in two Member States (in addition to Greece), SFA assumption would differ from the standard zero assumption over the medium-term, namely Finland and Luxembourg. Indeed, Finland and Luxembourg are characterised by *significant and recurrent positive* SFA values due to the build-up of public pension funds, with accumulated assets amounting to about 90% and 30% of GDP respectively. ([107]) In both

([104]) See for more information Eurostat (2023), 'Stock-flow adjustment for the Member States, the euro area and the EU, for the period 2019-2022', as reported in the April 2023 EDP notification (https://ec.europa.eu/eurostat/documents/1015035/16536421/SFA-PR-2023-Apr.pdf/ad4e15c0-a532-63d6-3f83-532d6429521b?t=1682009729585).

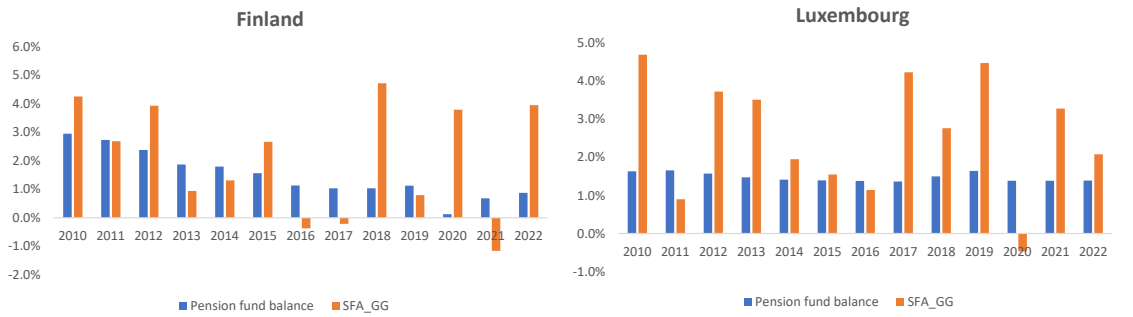
([105]) For example, most Member States experienced a temporary increase in SFA, during the 2008 global financial crisis, reflecting necessary government measures (with in particular, the use of non-budgetary measures such as bank recapitalisation operations).

([106]) Other institutions (e.g., OECD, ECB) already allow for non-zero SFA assumption in similar specific cases.

([107]) Figures based on the forthcoming 2024 Ageing Report projections.

Member States, the public pension system registers surpluses, recorded as part of the general government headline balance. This surplus is then used for the building-up of pension funds – and not to reduce debt -, materialising through the acquisition of financial assets, and recorded as a positive SFA (see Graph II.2.2). ([108]) Moreover, the use of the surplus of the public pension system for the building-up of the fund is guaranteed by law in both countries. ([109]) Last, the regular Ageing Reports (and in particular, the forthcoming 2024 edition) include projections of the public pension system surplus and the pension fund position based on commonly agreed assumptions and methodologies – prepared by the Economic Policy Committee / Ageing Working Group.

Graph II.2.2: **Social security funds' balance and SFA, % of GDP until 2022**



(1) SFA_GG refers to general government SFA
Source: Commission Services (AMECO) and figures from the forthcoming 2024 Ageing Report projections.

II.2.3. REVISED ASSUMPTION AND IMPACT ON MEDIUM-TERM DEBT PROJECTIONS AND FISCAL SUSTAINABILITY INDICATORS

II.2.3.1. Countries building public pension funds

The revised assumption makes use of the Ageing Report projections and is based on a no-policy change principle. *Over the standard T+10 DSA horizon*, SFA assumptions are directly based on the Ageing Report projections of the public pension system (fund) balance (in line with the no-policy change principle underpinning the DSA baseline). *Beyond the T+10 DSA horizon*, SFA are assumed to converge to zero, either according to a triggering criterion explicitly defined by the date when the fund is projected to be depleted (i.e., in Luxembourg, the fund is projected to be depleted as of 2047, meaning that as of this date the SFA for this country are set to zero). Otherwise, in the absence of any triggering criterion and if the position of the public pension fund is projected to keep increasing over time (as the result of property income as in Finland), SFA are assumed to gradually revert to a zero SFA assumption (in 10 years after the DSA projection horizon, meaning that, SFA are set to zero by T+20), reflecting the overall uncertainty surrounding the evolution of key drivers of SFA in the longer term.

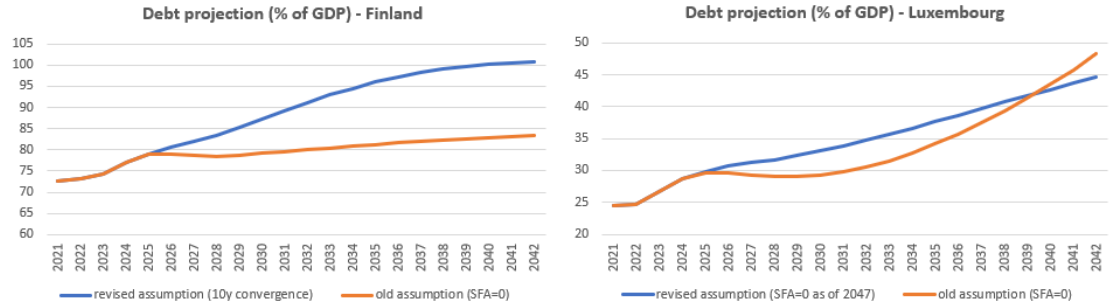
This revision has a significant effect on public debt projections, especially for Finland, but a limited impact on the long-term fiscal sustainability indicators. Based on the Commission autumn forecast

([108]) Looking at past balances of public pension funds and general government SFAs for Finland and Luxembourg, it confirms that although the correlation is not perfect, the series have been generally both positive and well correlated. The imperfect correlation is explained by the difference in scope of series (i.e., social security fund sub-sector vs. general government) and composition (with the general government SFA including specific components such as the cash-accrual adjustment to the ESA deficit, valuation effect adjustments and statistical discrepancies).

([109]) In Luxembourg, legal provisions earmark pension contributions and property income generated by the pension fund exclusively to the pension fund accumulation. They also foresee a pension deficit to be financed by tapping into the pension reserve fund in the future. In Finland, there is rather a mix of established practice and laws. Pension contributions are seemingly accumulated in the fund by usual practice, while property income, on the other hand is accumulated to the pension fund by law.

2023 and the forthcoming 2024 Ageing Report projections, such a change in the SFA assumption would increase projected debt by T+10, by 13 and 5 pps of GDP in Finland and Luxembourg respectively, compared with the previous assumption (assuming zero SFA beyond the short-term forecast period; Graph II.2.3 – upper panel). Regarding the long-term fiscal sustainability indicators, the impact of the change in the SFA assumption would be very limited in both Member States with no repercussions in terms of classification (Graph II.2.3 – lower panel).

Graph II.2.3: **Impact of alternative SFA assumptions on debt projections, the long-term risk classification and the sustainability indicators S2 and S1**



Long-term risk classification and the sustainability indicators S2 and S1

		S1	S2	Overall LT risk category
FI	Current assumption (SFA = 0)	1.7	3.2	Medium
	Adjusted assumption (SFA different from 0 until T+10, and convergence to 0 by T+20)	2.0	3.3	Medium
LU	Current assumption (SFA = 0)	3.8	8.6	High
	Adjusted assumption (SFA = 0 when fund is depleted in 2047)	3.5	8.6	High

(1) 'Old assumption' refers to the current standard assumption where SFA is set a zero beyond the short-term forecast. 'Revised assumption' refers to the case where SFA values are different from 0 over T+10 (using figures of the forthcoming 2024 Ageing Report) and converge to zero beyond T+10 in 10 years (in the case of Finland) and by 2047 in the case of Luxembourg.
Source: Commission services (based on the forthcoming 2024 Ageing report).

II.2.3.2. Countries with interest deferrals due to official lending: the case of Greece

Greece had also recorded over the past years *significant and recurrent* negative SFA values due to deferred debt interest payments on EFSF loans in the context of past financial assistance. ([110]) These deferred interested amounted to 5.4% of GDP in 2022 and estimated to reach 11.1% of GDP in 2032. Deferred interest payments on loans are currently not recorded in the (Maastricht) debt, which is defined in cash terms, but they affect the budget balance, which follows the accrual principle. As a result, in the years of the payment deferral, the corresponding amounts appear in the budget balance without affecting the debt dynamics, generating negative SFA. Instead, in the years where the outstanding financial liability is effectively repaid, the related amounts do not affect the budget balance (as they have already been recorded) but increase debt, via positive SFA. These flows were already taken into account in the debt projections, via small negative SFAs in the years of the deferrals (i.e., until 2032), and a large positive SFA in 2033 i.e., the year of the expiry of the deferral.

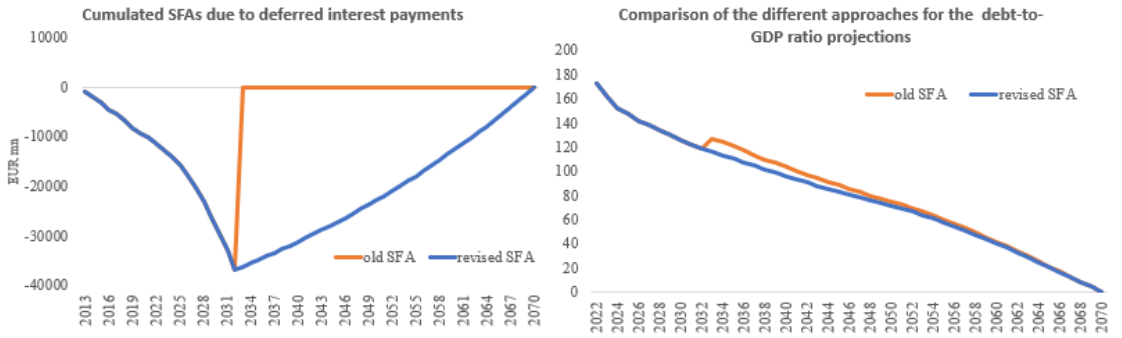
A revision of the SFA assumption is included in this report to better align the projections to statistical rules. The new SFA profile continues to apply small negative SFAs in the years of the

([110]) In the case of Greece, the current assumption is already different from the standard zero assumption with negative SFAs until 2032, positive SFAs in 2033 (equals to the sum of total deferred amounts), and zero SFAs from then onwards.

deferrals, but instead of adding the deferred amounts to the debt in 'one go' in 2033, it applies small positive adjustments in line with the actual repayment of the deferred amounts, aligning the current approach with EDP accounting. ([111]) (see Graph II.2.4 - left).

This revision has a (decreasing) impact on the debt projections in the medium-term, but no impact over the long-term. Based on the autumn forecast 2023, such a change in the SFA assumption has an impact on Greek projected debt by T+10 (about 10.8 pps. of GDP lower than the former assumption) but has no impact on projected debt over the long term, as the amount to be repaid is remains the same (see Graph II.2.4 - right). For this reason, the revision of the SFA assumption doesn't affect the values of the long-term fiscal sustainability indicators.

Graph II.2.4: **Impact of alternative SFA assumptions on debt projections for Greece**



Source: Commission services.

([111]) Recent discussions with ESM/EFSF have clarified that, at the end of the payment deferral period, Greece would repay the deferred interests according to a [linear] payment profile (instead of issuing a new loan at the end of the deferral period as assumed previously).