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The 2023 Stability & Convergence Programmes

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

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The 2023 Stability & Convergence Programmes

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EXECUTIVE SUMMARY

The economic recovery and high inflation resulted in further reductions in general government deficit and debt ratios in 2022. The EU economy continued its post-pandemic recovery at a strong pace in 2022. Real GDP grew by 3.5%, after the post-pandemic rebound of 5.4% in 2021. Diversification of energy sources and infrastructural investment to address gas supply bottlenecks and boost renewable energy, supported by the Recovery and Resilience Facility (RRF), allowed the EU economy to remain resilient to the energy supply shock related to Russia's war of aggression against Ukraine. The aggregate EU fiscal deficit fell to 3.4% of GDP, from 4.8% of GDP in 2021, driven by favourable macroeconomic developments and the phasing out of COVID-19 temporary emergency measures. The fall in the deficit came despite sizeable budgetary costs related to measures to soften the impact of high energy prices on households and firms. The aggregate EU debt ratio decreased significantly, to around 85% of GDP, from the historically high level of around 92% of GDP in 2020. High inflation supported this decline, with nominal GDP growth exceeding the cost of servicing debt ($r < g$) despite higher interest rates.

The Commission 2023 spring forecast points to a further reduction in the aggregate EU fiscal deficit in 2023, to 3.1% of GDP. In contrast, Member States' Stability and Convergence Programmes (SCPs) project a slightly higher deficit in 2023. This can largely be explained by different cut-off dates for these projections, especially related to the assumed budgetary impact of energy support measures in 2023. The decline in the deficit projected by the Commission is driven by the full phasing out of COVID-related support, a small reduction in energy support measures and a drop in subsidies to private investment, especially in Italy (see footnote 8). At the country level, budgetary developments are set to be quite heterogeneous, largely reflecting the different pace of phasing out energy support measures. Debt-to-GDP ratios are projected to decrease further due to persistently high inflation and the related favourable interest-growth rate differential.

After sizeable expansionary policies in 2020-22, the euro area fiscal stance is set to turn slightly contractionary in 2023. This is related to the partial phasing out of energy support measures and the reversal of subsidies to private investment (especially in Italy). By contrast, higher expenditure financed by RRF grants and other EU funds, and investment financed by national budgets are set to provide slightly expansionary contributions to the euro area fiscal stance this year. At the country level, the fiscal stance projections for 2023 are very heterogeneous, reflecting different developments in energy support measures.

The Commission has proposed quantitative fiscal country-specific recommendations (CSRs) for 2024, in line with the deactivation of the general escape clause of the Stability and Growth Pact (SGP). Member States are recommended to wind down their energy support measures, to preserve nationally financed public investment and to ensure the effective absorption of RRF grants and other EU funds, in particular to foster the green and digital transitions. The Commission forecast and the SCPs both expect the almost full phasing out of energy support measures, leading to similar deficit projections of around 2.5% of GDP for the EU in 2024. However, in most EU countries, government deficits are projected to remain above pre-pandemic levels in 2024, despite the phasing out of both energy and COVID-19 related support measures. This increase in government deficits points to the permanent nature of some fiscal policies implemented since the outbreak of the pandemic. This conclusion is corroborated by the overall expansionary stance of national budgets in 2020-24, in part related to higher public investment. The decline in debt-to-GDP ratios is expected to continue in 2024, although at a slower pace.

The euro area fiscal stance is projected to be contractionary in 2024, by around ¾% of GDP, driven by the projected near full phasing out of energy support measures, based on unchanged policies (NPC scenario). Most Member States appear to be on track to comply with the fiscal effort required in 2024 by the CSRs. However, in a few Member States, the projected contractionary stance is lower than the phasing out of energy support measures, which points to the use of related savings for purposes other than deficit reduction, including the indexation of some expenditure items to past inflation. At the same time, investment financed by national budgets is projected to continue to provide a slightly expansionary contribution to the euro area fiscal stance in 2024, consistent with the fiscal recommendations.

The RRF is set to continue supporting high-quality investment and reforms in 2023-24. Based on general government ESA2010 data, absorption of RRF grants in the EU increased to 0.3% of GDP in 2022 (from 0.2% in 2021). The Commission forecasts the absorption rate to further increase in 2023, to around 0.5% of GDP, and then to stabilise in 2024. Absorption of RRF grants is set to further increase in the coming years. The SCPs' projections up to 2026 show a cumulative contribution to investments and reforms by RRF grants of more than 2% of GDP in 15 EU countries (Bulgaria, Croatia, Czechia, Cyprus, Greece, Hungary, Italy, Latvia, Lithuania, Poland, Portugal, Romania, Slovenia, Slovakia and Spain).

In 2023-24, fiscal policy in the euro area is not set to fuel inflationary pressures and thus appears broadly consistent with the ongoing normalisation of monetary policy. The contractionary euro area fiscal stance projected for 2023-24 thus also appears consistent with the need to preserve macro-financial stability and debt sustainability, considering the impact of higher real interest rates on the financial sector and the cost of financing. Going forward, the need for several Member States to implement gradual fiscal adjustment to achieve fiscal positions consistent with headline deficits below 3% of GDP and a steady decline in high public debt ratios would result in a euro area fiscal stance remaining overall contractionary in the medium term.

In the Stability and Convergence Programmes (SCPs) most Member States plan further declines in government deficits in 2025-26. Deficits would be brought or maintained below 3% of GDP in 23 Member States in 2026. Bulgaria, Slovakia, Estonia, and France are the only four EU countries for which the SCPs project a deficit above 3% of GDP in 2026. The aggregate EU deficit would reach 1.7% of GDP in 2026, based on the SCPs. Despite smaller primary deficits than in previous years, the aggregate EU debt ratio would almost stabilise by the end of 2026 (at around 82% of GDP), with the interest-rate growth differential becoming significantly less favourable.

INTRODUCTION

This overview of the 2023 Stability and Convergence Programmes (SCPs) provides an aggregate picture of budgetary policy at the EU level. ⁽¹⁾ The analysis builds on a cross-country assessment of the SCPs, including an assessment of the fiscal stance and policy mix in the euro area.

The EU economy is set to continue expanding over the medium-term horizon of the SCPs, but inflation is a concern. National and EU budgets supported the strong post-pandemic recovery in 2021-22. Further sizeable fiscal support measures have been implemented in 2022-23 to respond to the energy price shock related to Russia's war of aggression against Ukraine. At the same time, the ECB and other EU national central banks have responded to high inflation by raising interest rates from historically low levels.

The Commission's Communication of 8 March 2023 provided guidance for the preparation of the SCPs. This guidance confirmed the deactivation of the general escape clause of the Stability and Growth Pact (SGP) at the end of 2023 and invited Member States to implement fiscal policies that aim at preserving debt sustainability while raising growth potential in a sustainable and inclusive manner, thus facilitating the task of monetary policy. On 24 May, the Commission proposed quantitative fiscal country-specific recommendations (CSRs) that are fully consistent with the current SGP legislation, considering to the extent possible some elements of the legislative reform package proposed by the Commission on 26 April 2023, which is now being discussed by the relevant legislators. ⁽²⁾ ⁽³⁾

Almost all EU Member States submitted their 2023 SCPs to the Commission by the deadline of April 30, as required by Council Regulation (EC) No 1466/97. The SCPs were produced before the publication of the Commission 2023 spring forecast and, in some cases, have different assumptions on the budgetary impact of energy support measures in 2023-24.

This paper consists of three sections, five boxes and two annexes. Section 1 examines budgetary developments in 2022, in the context of the macroeconomic environment. Section 2 focuses on the macroeconomic and budgetary projections for 2023 and 2024 in the SCPs compared with the Commission 2023 spring forecast, including the country-specific fiscal stances based on the latter. Section 3 looks at the euro area as a whole and assesses the aggregate fiscal stance and the policy mix. The topics of the analytical boxes are: i) the impact of surprise inflation on budgetary and debt developments; ii) the independent assessment of forecasts underpinning the 2023 SCPs, iii) the energy support measures implemented in 2022-23; iv) developments in defence spending as based on information in the SCPs; and v) interest rates, interest expenditure and public debt structure. Annex I presents the analysis of fiscal sustainability risks over the short, medium and long term based on the Commission 2023 spring forecast, while Annex II presents key macro-fiscal indicators available from the 2023 SCPs and the Commission 2023 spring forecast.

⁽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.

⁽²⁾ Proposal for a Regulation of the European parliament and of the Council on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, COM(2023) 240 final; Proposal for a Council Regulation amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure COM(2023) 241 final; Council regulation amending Directive 2011/85/EU on requirements for budgetary frameworks of the Member States COM(2023) 242 final.

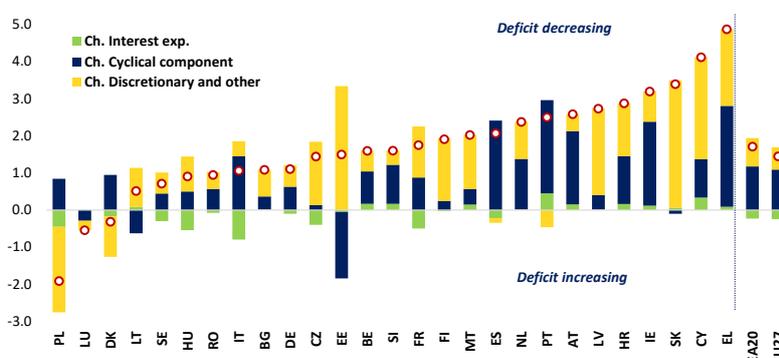
⁽³⁾ The Commission's legislative proposals to reform the EU's economic governance rules include strengthening national ownership through Member States' submission of medium-term plans setting out their fiscal targets, together with a single operational indicator for fiscal surveillance defined in terms of primary expenditure, net of discretionary revenue measures.

1. FISCAL DEVELOPMENTS IN 2022

1.1. BUDGETARY DEVELOPMENTS

General government deficits fell in most EU Member States in 2022, driven by the economic recovery. The EU aggregate deficit decreased from 4.8% of GDP in 2021 to 3.4% in 2022 (from 5.3% to 3.6% for the euro area). Eleven EU countries recorded a deficit in excess of 3% of GDP compared to 15 in 2021 (Table AII.4 in Annex). Greece and Cyprus experienced the largest deficit reduction in 2022 (over 4% of GDP; Graph 1.1), while the deficit increased significantly in Poland (almost 2% of GDP).⁽⁴⁾ The generalised fall in public deficits was primarily due to the impact of the cyclical component of the budget (dark blue bar in Graph 1.1), with real GDP growth in 2022 exceeding potential output growth in all EU countries with the notable exception of Estonia and, to a lesser extent, Lithuania, Luxembourg and Slovakia.

Graph 1.1: Drivers of the change in the budget balances in 2022 (% of GDP)



Source: European Commission 2023 spring forecast

Discretionary fiscal policy provided a deficit-decreasing impact, driven by the phasing out of pandemic-related measures (Graph 1.1). For the EU aggregate, COVID-19 temporary emergency measures declined from 3.1% in 2021 to 0.7% of GDP in 2022 (Table AII.9 Annex). This decline more than offset the net budgetary costs related to measures to soften the impact of high energy prices on households and firms (1.2% of GDP for the EU; Box 2.2; Table AII.8 in Annex) and the additional costs to shelter and integrate people fleeing the war in Ukraine (0.1% of GDP for the EU; Table AII.10 in Annex).⁽⁵⁾ Inflation surprises provided a further deficit-decreasing contribution as some big Member States experienced revenue windfalls, especially related to imported energy,⁽⁶⁾ while several expenditure items are only expected to adjust to high inflation with a delay (Box 1.1).

Interest expenditure increased in around half of EU countries in 2022 (green bar in Graph 1.1). In Italy, France, Poland and Hungary this increase was significant (0.5% of GDP or more), driven by higher interest rates and/or higher yields on government bonds indexed to inflation.⁽⁷⁾

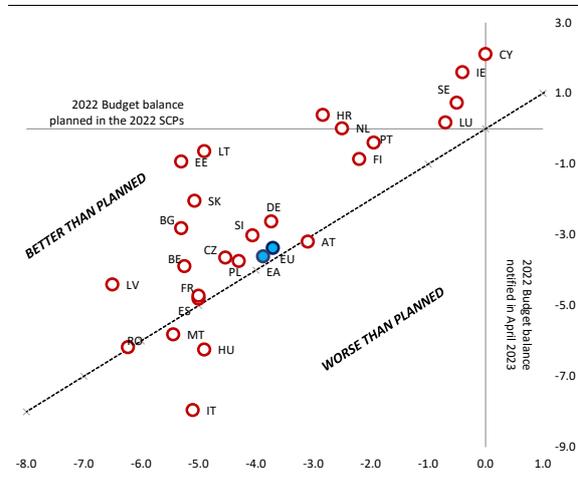
⁽⁴⁾ In Poland, the deficit was particularly affected by the cost of aid to displaced persons from Ukraine, the adverse impact of the reform of personal income tax, higher interest expenditure and a sizeable increase in capital transfers, largely reflecting government support to financial institutions.

⁽⁵⁾ The budgetary costs of sheltering refugees mask significant difference across countries, with the largest budgetary impact incurred in Poland and Estonia (0.5% of GDP or more).

⁽⁶⁾ Revenue windfalls (shortfalls) are estimated through the increase (decrease) in the revenue-to-GDP ratio that is not explained by discretionary measures or transfers from the EU budget. Based on the Commission 2023 spring forecast, revenue windfalls in the EU overall are estimated at ¼% of GDP in 2022, after windfalls of ½% and ¾% in 2020 and 2021, respectively (Denmark is excluded from the EU aggregate in 2022, as it was an outlier with a big fall in the revenue-to-GDP ratio largely affected by developments in the energy sector).

⁽⁷⁾ See also Graph 2.7 in Section II.

Graph 1.2: Budget balances, 2022 outcome vs 2022 SCPs (% of GDP)



Source: European Commission 2023 spring forecast and 2022 SCPs

In most EU countries deficits in 2022 turned out to be lower than planned in spring last year. Only in four countries (Italy, Hungary and, to a lesser extent, Malta and Austria) the deficit outcome was higher than planned in the 2022 SCPs. (Graph 1.2). In the case of Italy, the deficit was much higher than anticipated due to the new statistical recording of sizeable tax credits for housing renovation. Those tax credits are now classified as ‘payable’, thus recorded as expenditure (capital transfers) at the time when the renovations are actually implemented (i.e. mostly in 2021 and 2022).⁽⁸⁾

1.2. PUBLIC DEBT DEVELOPMENTS

The economic recovery and high inflation supported further reductions in debt-to-GDP ratios in 2022 (Graph 1.3). In all EU countries nominal GDP growth was higher than the implicit interest rate paid on debts ($r < g$), resulting in a debt-decreasing ‘snowball effect’.⁽⁹⁾ At the same time, most Member States (exceptions are Greece, Cyprus, Portugal, Ireland, Croatia, Denmark and Sweden) still recorded primary deficits that, weighing on debt developments in 2022. The pace of decline in the debt-to-GDP ratio varied across countries, with exceptionally large falls recorded in Greece, Ireland, Cyprus, Portugal and Croatia, where debt ratio developments benefited from both high nominal GDP growth and debt-decreasing primary surpluses.

Thirteen Member States had a debt ratio above the 60% of GDP threshold at the end of 2022 (Table AII.6 in Annex). Belgium, Greece, Spain, France, Italy and Portugal had a debt ratio above 100% of GDP in 2022. In Ireland, the debt ratio stood at around 45% of GDP at the end of 2022, but as a share of ‘modified gross national income’⁽¹⁰⁾ – a more accurate measure of repayment capacity in Ireland – it was around 83%. The public debt-to-GDP ratio turned out lower than projected in the 2022 SCPs in all Member states except two (Finland and Czechia). For the EU aggregate, the debt-to-GDP ratio decreased to around 85% at the end of 2022 (93% in the euro area), still well above the 2019 level of 79% of GDP (86% for the euro area).⁽¹¹⁾

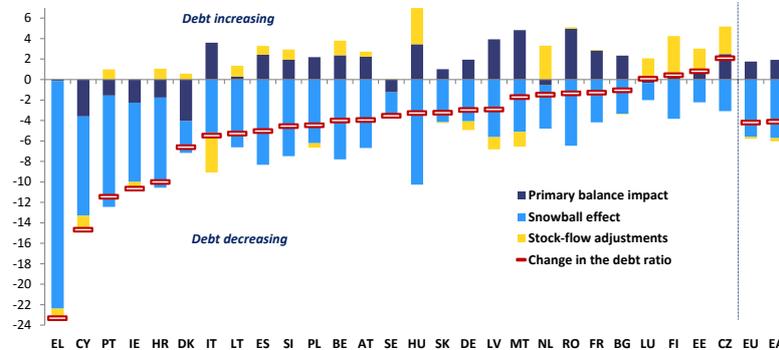
⁽⁸⁾ Following Eurostat’s letter that provided formal advice (“Statistical recording of Superbonus 110%, Transition 4.0 and other renovation tax credits”; Ref. ARES(2023)1472618 of 28/2/2023), ISTAT reclassified a large part of these tax credits as ‘payable’, with a budgetary impact at the time the tax credit is earned, that is, at the time when the investment is made. For Superbonus 110% the budgetary impact is now projected to decline from 2.6% of GDP in 2022 to 0.7% in 2023 and 0.3% in 2024.

⁽⁹⁾ The ‘snowball’ effect captures the impact of interest expenditure on the annual accumulation of debt in combination with the impact of real GDP growth and the GDP deflator growth on the debt ratio.

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

⁽¹¹⁾ Figures for the EU and euro area debt-to-GDP ratios are not consolidated for intergovernmental loans.

Graph 1.3: Drivers of the change in the debt-to-GDP ratio in 2022 (pps. of GDP)

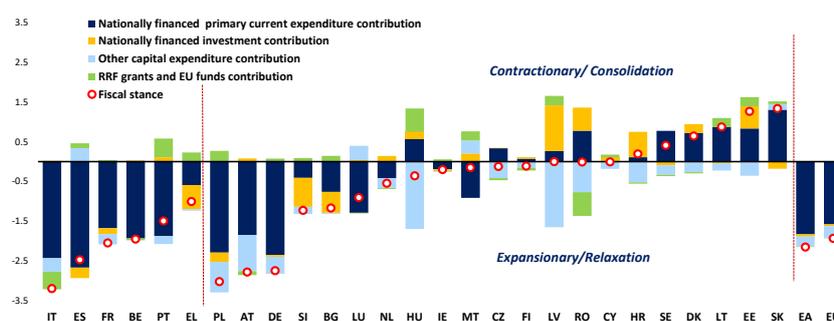


Source: European Commission 2023 spring forecast

1.3. FISCAL STANCE

The fiscal stance was expansionary in most EU countries in 2022. It was particularly expansionary, more than 2.5% of GDP, in Italy and Spain (among high-debt countries) as well as in Poland, Austria and Germany (among low- and medium-debt countries). The fiscal stance indicates the short-term impulse of fiscal policy on the economy, financed by both the national budgets and the EU budget. ⁽¹²⁾ The latter includes grants from the Recovery and Resilience Facility (RRF) and other EU funds, which are sizeable for some Member States (green bar in Graph 1.4). Within the fiscal stance financed by the national budgets, the Commission's analysis separates the impact of investment (orange bar in Graph 1.4), other capital expenditure (light blue bar in Graph 1.4) and net primary current expenditure (dark blue bar in Graph 1.4).

Graph 1.4: Fiscal stance in 2022 and components (% of GDP)



Note: the graph shows the stance of high debt countries on the left, of low/medium debt countries in the centre and the EA and EU stance on the right.

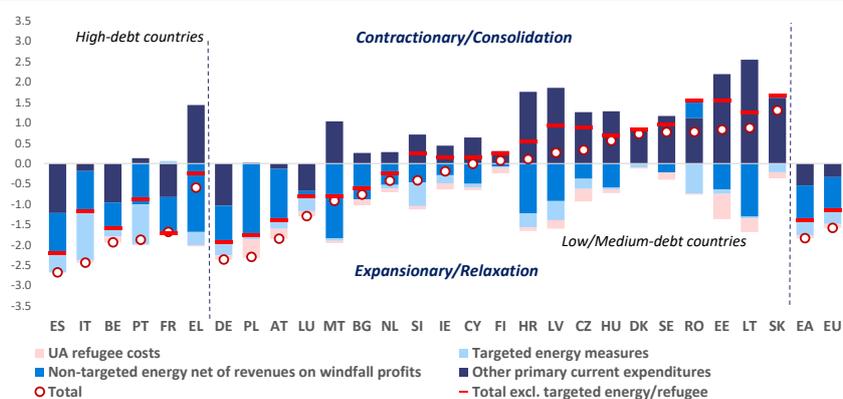
Source: European Commission 2023 spring forecast

⁽¹²⁾ In this paper, the fiscal stance is measured through the Discretionary Fiscal Effort (see Nicolas Carnot, Francisco de Castro 2015, The Discretionary Fiscal Effort: an Assessment of Fiscal Policy and its Output Effect, *European Economy*, Economic Papers 543). It is based on the increase in primary expenditure (net of discretionary revenue measures) relative to 10-year nominal potential output growth (Table AII.11 in Annex), indexed using the annual increase in the GDP deflator (Table AII.2). The net expenditure aggregate used to assess the fiscal stance includes expenditure financed by RRF grants and other EU funds and excludes the temporary emergency measures related to COVID-19. COVID-19 temporary emergency measures are not included in the fiscal stance as they were largely implemented in 2020-21, when most economic activities were restrained due to the health situation and a sizeable part of these measures had a cyclical nature (e.g. support for short-time work schemes in substitution of unemployment benefits). This pandemic-related support is assumed to be fully phased out in 2023, however it still has an important bearing on economic activity in the euro area through pent-up demand. The delayed impact of high inflation on some expenditure items makes more difficult the assessment of the fiscal stance at the current juncture (Box 1.1).

Primary current expenditure financed by national budgets (net of discretionary revenue measures) was the main driver of the expansionary fiscal stance in 2022. This component had an expansionary contribution in more than half of the EU countries (1½ pps. of GDP for the EU aggregate; Graph 1.4). Five high-debt Member States (Spain, Italy, Belgium, Portugal and France) increased net primary current expenditure significantly above their medium-term potential growth rate in 2022, with an expansionary contribution to the fiscal stance over 1½ pps. of GDP. Other capital expenditure, which boosted private investment, provided a sizeable expansionary contribution to the fiscal stance in Italy, Poland, Austria, Germany, Hungary, Latvia, Romania and Croatia.

Energy support measures had a sizable impact on the fiscal stance in 2022. In 2022, all governments took measures to mitigate the impact of high energy prices on households and firms (Box 2.2; Table AII.8 in Annex). In most cases, the measures were not targeted at those households and firms most vulnerable to high energy prices (see distinct bars in Graph 1.5). In Spain, Belgium, France, Germany and Luxembourg the increase in net primary current spending - not related to (targeted and untargeted) energy support measures - was significantly higher than 10-year nominal potential output growth. This increase provided an expansionary contribution of more than 0.5 pps. of GDP (dark blue bar in Graph 1.5).⁽¹³⁾ By contrast, in a number of Member States that experienced very high inflation (GDP deflator) in 2022 (Greece, Slovenia, Croatia, Latvia, Czechia, Hungary, Denmark, Romania, Estonia, Lithuania and Slovakia) the increase in net primary current expenditure - not related to (targeted and untargeted) energy support measures - was lower than 10-year nominal potential output growth. This development resulted from several expenditure items that are set to adjust to high inflation with a delay (Box 1.1).

Graph 1.5: **Contribution to the 2022 fiscal stance from nationally financed net primary current expenditure and drivers (pps. of GDP)**



Note: the graph shows the stance of high debt countries on the left, of low/medium debt countries in the centre and the EA and EU stance on the right.

Source: European Commission 2023 spring forecast

⁽¹³⁾ The Council's fiscal CSRs of 18 June 2021, invited only six Member States (Italy, Portugal, Bulgaria, Croatia, Latvia and Lithuania) to limit (for high debt countries) or keep under control (for low- and medium-debt countries) nationally financed (primary) current expenditure, based on the no-policy-change Commission 2021 spring forecast, which projected in those countries an expansionary contribution of this component to the fiscal stance of more than 0.5 pps. of GDP.

Box 1.1: Impact of surprise inflation on budgetary and debt developments

Inflation surprises can provide temporary relief for public finances in the short term. This reflects the combination of a quick rise in tax revenues accompanied by a more delayed reaction on the expenditure side, while outstanding government debt declines relative to nominal GDP (denominator effect).⁽¹⁾ More specifically, on the revenue side, inflation swiftly raises tax collection, especially indirect taxes. The impact on direct taxes is usually smaller and less immediate: collection will increase to the extent that nominal increases in wages and other incomes shifts taxpayers into higher tax brackets, if there is no automatic indexation of those brackets – a phenomenon referred to as the fiscal drag⁽²⁾. Outturn data confirm that revenue windfalls have been high in 2022 in most Member states in the EU⁽³⁾. On the expenditure side, nominal spending initially reflects inflation surprises only partially – a phenomenon referred to as benefit erosion – as approximately only a third of government expenditure is indexed to prices and mostly with a lag of one year.⁽⁴⁾⁽⁵⁾ Empirical findings often confirm the existence of a positive temporary impact on the primary balance, following a surprise rise in inflation.⁽⁶⁾ However, this positive impact is expected to fade away over time and may even be reversed as government expenditure catches up with higher inflation.

The short-term impact on public finances is however likely to be less favourable when the initial inflation surprise is largely driven by an adverse (supply) external factor, such as the terms-of-trade shock caused by the recent energy price spike⁽⁷⁾. In the event of an (imported) supply shock, inflation reduces households' real income and consumption, and eventually (real) activity. This has a dampening effect on tax revenues in real terms. As also happened in the recent energy price shock, such developments prompt governments to compensate households and firms for the higher costs they incur through measures, such as subsidies, that could prove difficult to target to those most vulnerable. The revenue-to-GDP ratio in the EU declined in 2022, mainly due to the reduction in VAT rates and excise duties on energy products.

Long-lasting higher inflation tends to increase debt over time. Monetary policy tightening pushes interest rates up, eventually feeding into a higher debt burden. In practice, given that the average debt maturity in most euro area Member States is relatively high, this will happen only gradually as maturing debt is rolled over. Member States with a higher share of inflation-linked bonds or a lower average debt maturity will see a more rapid increase in debt-servicing costs. In addition, higher interest rates affect interest payments more strongly

- (1) Noteworthy, when inflation is (partly) driven by a terms of trade shock it causes a gap between the consumer price and the GDP deflator inflation, with the latter being more moderate. In turn, the direct effect of inflation on the government debt ratio, via the denominator effect, is driven by the GDP deflator inflation rather than the consumer price inflation, implying a more moderate effect.
- (2) This effect is clear when the personal income tax code establishes several income brackets with progressive tax rates but may also occur in situations of a single tax rate with a tax-free income allowance.
- (3) Revenue windfalls (shortfalls) are estimated through the increase (decrease) in the revenue-to-GDP ratio that is not explained by discretionary measures or transfers from the EU budget.
- (4) See evidence shown in ECB (2023) article in the Economic Bulletin Issue 2 entitled "Fiscal policy and high inflation". For more specific evidence on pension and public wages indexation see Checherita-Westphal, C. (ed.), "Public wage and pension indexation in the euro area: an overview", Occasional Paper Series, No 299, ECB, August 2022. See also European Commission (2021), The 2021 Ageing Report, Institutional Paper 148, May 2021 for indexation rules of public pension expenditure. IMF (2023), Fiscal Monitor, "Chapter 2: Inflation and Disinflation: What Role for Fiscal Policy", April 2023.
- (5) Another way of depicting these fiscal developments is by considering that the increase in tax collection broadly follows the evolution of nominal GDP, while the weight of expenditure in GDP tends to decline as inflation (initially) leads to a reduction of government expenditure in real terms. Over time, however, lagged indexation of government expenditure gradually restores the expenditure-to-GDP ratio back to its pre-inflationary shock level.
- (6) See IMF (2022), Fiscal Monitor online annex 1.3 entitled "Inflation and Fiscal Nexus: Empirical Findings, April 2022. See also Attinasi, M.G. et al., "The effect of low inflation on public finances", in Banca d'Italia, Beyond the Austerity Dispute: New Priorities for Fiscal Policy, No 20, March 2016. See also Berti, K. et al., "Fiscal reaction functions for European Union countries", European Economy Discussion Papers, No 028, April 2016.
- (7) See also ECB (2023) article in the Economic Bulletin Issue 2 entitled "Fiscal policy and high inflation", which provides simulation evidence that points to a sharp contrast between demand-driven and supply-driven inflation on debt-to-GDP developments, with the former leading to a lasting improvement and the latter to a lasting deterioration (i.e., an increase) in that ratio.

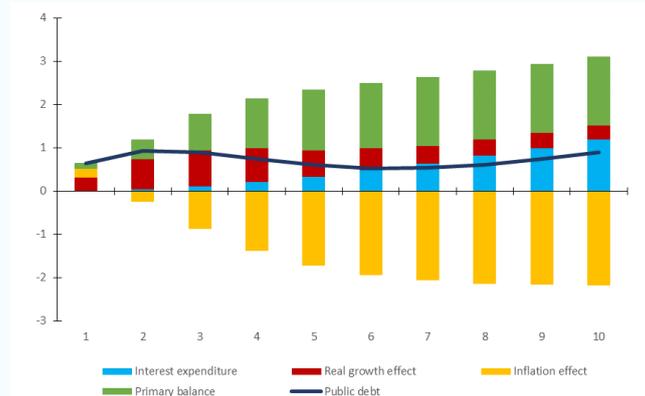
(Continued on the next page)

Box (continued)

when they apply to higher debt levels. In a monetary union, such channels may affect countries differently, notably as higher inflation in some countries may temporarily flatter public debt dynamics, while still eroding competitiveness.

The Commission’s stylised simulations confirm that the debt-to-GDP ratio eventually rises significantly when inflation is driven by a terms-of-trade shock. Graph 1a shows the impact of a (stylised) 1pp. persistent increase in inflation that is entirely due to an adverse terms-of-trade shock, i.e. no direct impact from domestic production factors. The channels illustrated in the graph show that while inflation would tend to lower the debt-to-GDP ratio via the denominator effect, a deterioration of real GDP growth partly offsets this denominator effect and causes a deterioration of the primary balance. Rising interest rates eventually also contribute to an increase in the debt-to-GDP ratio following the inflationary shock. The stylised simulations do not account for discretionary compensatory measures that may be taken by governments to cushion the impact of the shock on the most vulnerable households and, in turn, on the economy as a whole. However, if not temporary and targeted, these measures add fiscal pressure on top of the mechanical impact of inflation illustrated by the simulations. As inflation in the euro area has been underpinned by a wider range of factors than a deterioration in the terms-of-trade, as assumed in these simulations, the assessment of the impact of inflation on public finances can be somewhat more nuanced.

Graph 1a: **Impact of higher inflation caused by a terms-of-trade shock on EU debt dynamics (pps. of GDP compared to the baseline)**



Source: Commission services.

Note: This graph shows simulations from the Commission's debt sustainability analysis (DSA) model of a shock that causes a 1pp. increase in inflation due to an adverse terms-of-trade shock. The graph shows the impact of such a shock on the EU's public debt ratio compared with the Commission's baseline medium-term projections. Inflation persistence is assumed, with inflation only progressively converging back to baseline values over the projection horizon. Related effects, such as feedback effects on real GDP growth and interest rates, are calibrated based on the results of a similar simulation within the Commission's macroeconomic model QUEST. More detailed results are to be published in the Commission's Report on Public Finances in EMU 2022 and in a forthcoming Discussion Paper.

In the graph, higher inflation by 1pp. due to an adverse terms-of-trade shock would increase debt by around 1 pp. of GDP in year t+10 (dark line). The debt increase would be driven by lower real GDP growth (in red) and a deteriorated primary balance (in green). Moreover, monetary policy tightening in response to inflation would gradually increase interest payments after two years (in blue), as higher interest rates would gradually affect new or rolled-over debt. The debt-increasing impact – due to lower growth, weaker fiscal positions and higher interest rates – would only be partially offset by the debt-reducing impact of higher inflation via denominator effects (in yellow).

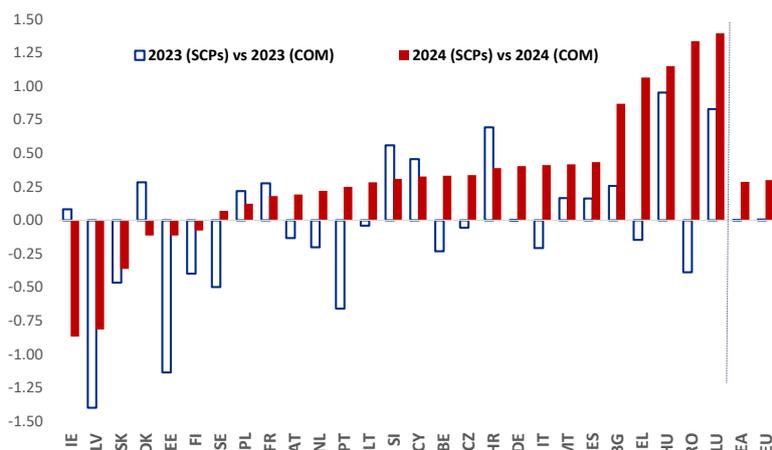
2. FISCAL PROJECTIONS FOR 2023, FISCAL PLANS FOR 2024 AND THE MEDIUM TERM

2.1. MACROECONOMIC PROJECTIONS

2.1.1. Macroeconomic projections for 2023

The economic recovery in the EU is set to continue in 2023, but at a more subdued pace. The Commission 2023 spring forecast and the SCPs expect a significant deceleration in economic activity in 2023, with real GDP growth in the EU dropping from 3.6% in 2022 to 1% in 2023 according to both (Table AII.1 in Annex). However, at the country level, there are some large differences between the SCPs' growth projections and the Commission forecast (Graph 2.1). For Latvia, Estonia and Portugal the SCPs expect real GDP growth in 2023 to be lower than in the Commission forecast by more than 0.5 pps. By contrast, the SCPs of Hungary, Luxembourg, Croatia and Slovenia are more optimistic than the Commission forecast, with real GDP growth higher by more than 0.5 pps. Different cut-off dates may explain some of the differences in these projections: as the cut-off date of the Commission forecast was 28 April, whereas SCPs were in general produced some weeks before. ⁽¹⁴⁾

Graph 2.1: Difference in real GDP growth projections for 2023 and 2024; SCPs vs COM (pps.)



Note: Positive figures indicate that SCPs' growth projections are higher than in the Commission forecast.

Source: European Commission 2023 spring forecast (COM) and 2023 SCPs

HICP headline inflation is set to decline in 2023, driven by the sharp fall in energy prices. The SCPs project a bigger decline than the Commission forecast, to 5.9 % and to 6.7%, respectively, from 9.2% in 2022 (Table AII.3 in Annex). There are some significant differences at the country level, especially in the case of Hungary and the Netherlands, where the SCPs project HICP inflation lower than the Commission forecast by 1.4 pps. and 2 pps. respectively.

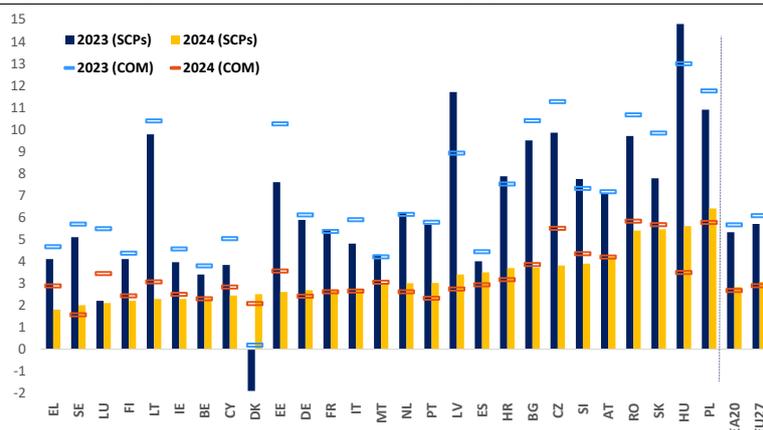
By contrast, the GDP deflator is set to increase further in 2023, driven by higher unit labour costs and profit margins. ⁽¹⁵⁾ The change in the GDP deflator is a bigger driver of fiscal developments than HICP inflation. The SCPs project the GDP deflator to accelerate to 5.7% for the EU in 2023, up from 5.4% in 2022. The Commission forecast expects an even bigger increase, to 6.1%. At the country level, differences of greater than 1 pp. between the two projections are observed for Luxembourg, Cyprus, Denmark, Estonia, Italy, Czechia and Slovakia, with the increase in the GDP deflator higher in the

⁽¹⁴⁾ Eurostat published on 20 April 2023 final data for GDP and main aggregates in Q4-2022 and on 28 April the preliminary flash estimate for GDP in Q1-2023.

⁽¹⁵⁾ See also "Box 1.2.3: Profit margins and their role in euro area inflation" in European Economic Forecast, Spring 2023 [European Economic Forecast, Spring 2023 \(europa.eu\)](https://ec.europa.eu/economic-forecast).

Commission forecast, whereas in Latvia and Hungary the SCPs project significantly higher GDP deflators (Graph 2.2; Table AII.2 in Annex). In the Commission forecast, double digit increases in the GDP deflator are projected for seven EU countries in 2023 (Estonia, Lithuania, Bulgaria, Czechia, Hungary, Romania and Poland).

Graph 2.2: Inflation (GDP deflator) in 2023 and 2024; SCPs and COM (%)



Source: European Commission 2023 spring forecast (COM) and 2023 SCPs

2.1.2. Macroeconomic projections for 2024

The SCPs are in general more optimistic than the Commission forecast about real GDP growth in 2024. Real GDP in the EU is expected to grow by 2% in the SCPs compared to 1.7% in the Commission forecast (Table AII.1 in Annex). For 21 countries the SCPs' growth projections are higher than the Commission forecast (Graph 2.1), with differences above 0.5 pps. in Luxembourg, Romania, Hungary, Greece, and Bulgaria. These SCPs appear even more optimistic when it is considered that the balance of risks surrounding the Commission forecast is tilted to the downside. For the six countries for which the SCPs expect more subdued growth than the Commission forecast, differences above 0.5 pps. are observed in Ireland and Latvia. The SCPs' macroeconomic projections were prepared or endorsed by independent fiscal institutions (Box 2.1), at least for the euro area Member States.

In 2024, HICP and the GDP deflator are expected to decelerate substantially in the EU. The increase in the GDP deflator is expected to fall to 3.1% in the EU in 2024 based on the SCPs and 2.9% based on the Commission forecast. At the country level, differences between the two projections that are greater than 1 pp. are observed for Luxembourg, Greece and Czechia, with the GDP deflator growth higher in the Commission forecast (Graph 2.2; Table AII.2 in Annex). For Hungary, the CP instead projects a significantly higher increase in the GDP deflator in 2024. In the Commission forecast, the GDP deflator growth is still projected to be above 4% for six EU countries (Slovakia, Slovenia and Austria, Czechia, Romania and Poland).

2.2. FISCAL PROJECTIONS

2.2.1. Budgetary projections for 2023

The SCPs project the EU aggregate deficit to increase to 3.6% of GDP in 2023, from 3.4% in 2022; while a fall to 3.1% is instead projected in the Commission 2023 spring forecast (Graph 2.3). The SCPs and the Commission forecast both reflect the full phasing out of COVID-19 temporary emergency measures (from 0.7% of GDP in 2022; Table AII.4 in Annex) as well as the lower capital transfers in

Box 2.1: Independent assessment of forecasts underpinning the 2023 SCPs

Realistic and unbiased forecasts help Member States produce more effective fiscal planning. This is why the EU legislation specifies that EU Member States should compare their macroeconomic and budgetary forecasts with the Commission forecasts and, where necessary, with those of other independent bodies ⁽¹⁾. Additionally, euro area countries shall have their national independent fiscal institutions (IFIs) either endorse or produce their macroeconomic forecasts and shall indicate whether the budgetary forecasts are endorsed or produced by these institutions ⁽²⁾.

Within the euro area, three main arrangements exist for macroeconomic forecasts. These forecasts are either produced by national IFIs (Belgium, Luxembourg, Netherlands, Austria and Slovenia), endorsed by national IFIs (Estonia, Ireland, Greece, Spain, France, Croatia, Italy, Cyprus, Latvia, Lithuania, Malta and Portugal), or endorsed by independent expert committees (Germany and Slovakia). In Finland, a department of the Ministry of Finance produces the macroeconomic forecast in line with the EU legal requirements regarding functional independence, but there is no official endorsement by an IFI.

In endorsing the macroeconomic forecasts underpinning the SCPs, many IFIs pointed to a high degree of uncertainty. Most IFIs remarked that the forecasts were realistic, although several IFIs noted that the forecasts were still subject to economic uncertainty, for example due to high inflation or the ongoing Russian war of aggression against Ukraine. The French IFI noted that the forecast was too optimistic, albeit within reach. In Ireland, the IFI welcomed the extension of the government forecast to 2030, noting that a longer-term focus would help to better understand the economy's medium-term trajectory.

In the Member States outside of the euro area, other arrangements exist. Many non-euro area IFIs assess or endorse the macroeconomic forecasts used in annual budgets, but not always the forecasts used in the Convergence Programmes. However, the independently nominated Czech Committee on Budgetary Forecasts still assessed the macroeconomic forecast used in the Czech Convergence Programme, stating that they found it realistic.

⁽¹⁾ Art. 4(1) of the Council Directive 2011/85.

⁽²⁾ Art. 4(4) of the Two-Pack Regulation (EU) No 473/2013.

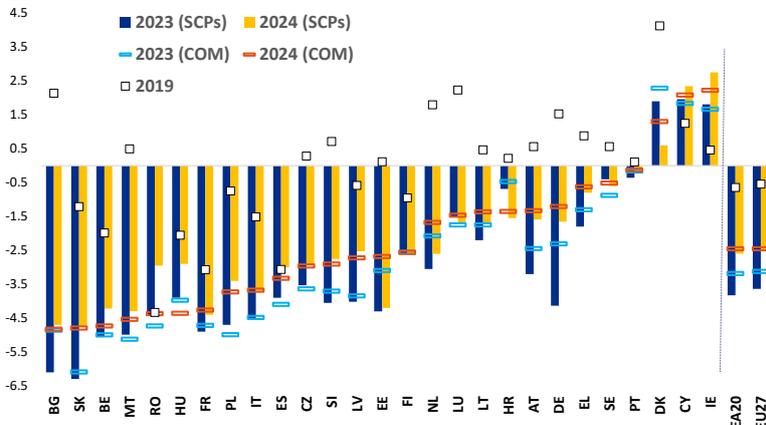
Italy. ⁽¹⁶⁾ The Commission forecast also assumes a slight reduction in the budgetary costs of energy support measures (to 1.1% of GDP in 2023, from 1.2% in 2022; Box 2.2; Table AII.8 in Annex). The higher 2023 deficit projection in the SCPs is largely explained by different estimates of the costs of energy support measures, as some programmes were produced when assumptions on energy prices were higher than in the Commission forecast. The Commission forecast projects large revenue shortfalls in 2023, of around ¾% of GDP, which appear to be a (partial) reversal of the revenue windfalls recorded in 2020-22. ⁽¹⁷⁾ The number of countries with a deficit above 3% of GDP is projected to increase from 11 in 2022 to 16 in 2023, based on the SCPs, and to 14, based on the Commission forecast. ⁽¹⁸⁾

⁽¹⁶⁾ See footnote 8.

⁽¹⁷⁾ For a definition of revenue windfalls/shortfalls see footnote 6. In this paper, the computation of revenue shortfalls/windfalls is based only on the Commission 2023 spring forecast.

⁽¹⁸⁾ Romania is the only country already under EDP. On 24 May 2023, the Commission confirmed that it will propose to the Council to open deficit-based excessive deficit procedures in spring 2024 on the basis of the outturn data for 2023, in line with existing legal provisions. Member States should take account of this when executing their 2023 budgets and when preparing their draft budgetary plans for 2024 this autumn (see COM(2023) 600 final).

Graph 2.3: Budget balance projections in 2023 and 2024 vs 2019 level; SCPs and COM (% of GDP)



Source: European Commission spring forecast 2023 (COM) and 2023 SCPs

2.2.2. Main budgetary measures taken by Member States in 2023

High inflation has put upward pressure on government expenditure in several Member States. This is in particular due to increases in public sector wages (for example in Belgium, Poland, Portugal and Slovakia) or increases to old-age pensions or other social benefits (for example in Belgium, Bulgaria, Italy, Greece, Poland, Portugal and Spain). Some of these increases are due to discretionary measures on the part of governments, while others are driven by more automatic channels, such as indexation of pensions to inflation, normally with a one-year delay.

Support measures connected to the Russian invasion of Ukraine, in particular concerning the high prices of energy, continue to put upward pressure on deficits. In 2023, Member States' general government deficits continued to be impacted by temporary measures to mitigate the economic and social impact of high energy prices on households and firms. Costs to support people who fled the Russian invasion of Ukraine also put upward pressure on deficits, though to a much lesser extent. In addition, as a consequence of the security challenges raised by the war, many countries started spending more on defence (see Box 2.3). In contrast, COVID-19 temporary emergency measures, which amounted to 0.7% of the GDP in the EU in 2022, are projected to be fully phased out in 2023.

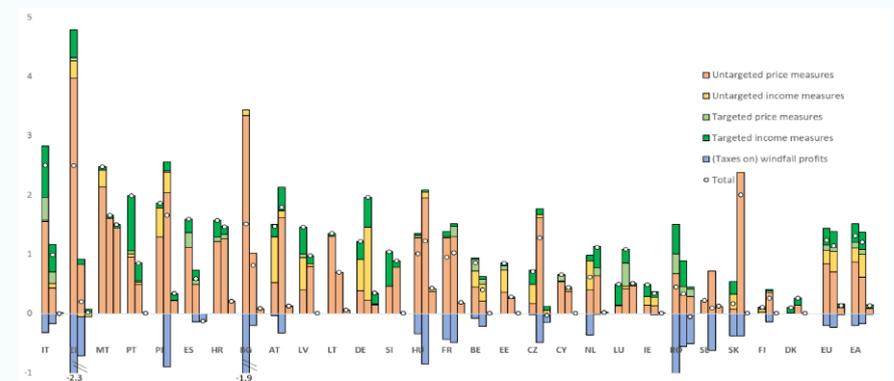
Support to households and businesses to mitigate the economic and social impact of energy price hikes remains considerable. Support consists of measures that decrease government revenues (e.g. reduction of indirect taxes and levies on energy products) and those that increase government expenditures (e.g., subsidies on energy production, transfers to households and corporations for energy consumption, and temporary increases to social benefits). In some Member States, the cost of these measures has been partly offset by new taxes on windfall profits of energy producers and suppliers. The Commission 2023 spring forecast estimates the net budgetary cost of the measures at 1.1% of GDP in 2023 in the EU, compared to 1.2% of GDP in 2022, with a high degree of variation among the Member States. In nine Member States (Sweden, Greece, Finland, Denmark, Estonia, Romania, Ireland, Belgium and Cyprus) the net budgetary impact of these measures is projected at below 0.5% of GDP, while in five (Slovakia, Germany, Austria, Poland, Malta) it is projected at above 1.5% of GDP. Most Member States currently plan to phase out these measures and their net budgetary cost is forecast by the Commission (assuming unchanged policies) at 0.1% of GDP in 2024 (Box 2.2).

Box 2.2: Fiscal policy measures to mitigate the impact of high energy prices

High energy prices have prompted most Member States to continue providing support to households and firms in 2023 but these measures are projected to be phased out in 2024. The net budgetary cost of measures to mitigate the impact of high energy prices on households and firms is projected by the Commission to amount to 1.1% of the EU GDP in 2023, compared to 1.2% of EU GDP in 2022. Several support measures have already been phased out since the end of winter. Lower energy prices are also reducing the budgetary impact of some existing support measures, such as subsidies to energy providers to maintain price ceilings. Assuming unchanged policies, support measures are projected to be phased out almost entirely by 2024, with a remaining budgetary impact of 0.1% of GDP in the EU, leading to significant (potential) savings in most Member States.

The Commission estimates refer to the aggregate budgetary impact on the general government balance of discretionary measures to support households and firms. For the purposes of these estimates, energy measures are defined as: (1) measures that have a direct impact on the marginal cost of energy consumption for households and/or firms ('price measures'); (2a) measures that provide temporary income support to households; (2b) measures that provide compensation to firms (other than price measures) in energy-intensive industries (both 'income measures'); and (3) revenues from new taxes or levies on the windfall profits of energy companies. Purely regulatory measures or measures that are administered by public (or private) corporations outside the general government sector are not included, unless the government provides a direct compensation to the companies involved (e.g. in the form of a subsidy or capital transfer to cover the losses resulting from these support measures. Recapitalisations of energy companies in distress caused by general market conditions unrelated to the support measures are not included in these estimates). Moreover, the estimates do not include the (semi-)automatic adjustments of social benefits to the general price level or the impact of the deceleration in economic activity on tax collection, as these channels are not considered to be a 'measure'. Permanent increases in public salaries and social benefits are also not included in these estimates as their permanent nature prevents them from being phased out once the peak in energy prices has subsided.

Graph 2a: **Budgetary cost of fiscal measures to mitigate the impact of energy price increases in 2022, 2023 and 2024 (% of GDP).**



Source: European Commission Spring forecast 2023

Most of the adopted measures are not targeted to the most vulnerable households or firms, while more than half do not preserve price incentives for demand reduction. In 2023, three quarters of the projected budgetary cost is on measures that are not targeted to the most vulnerable households and businesses. Moreover, 55% of the budgetary cost is on price measures (see Graph 2a), i.e., those that directly target the final energy price, such as lowering indirect taxes, reducing levies or increasing subsidies for energy products, and direct interventions in price setting. Price policies reduce the signalling effect of higher energy prices on demand and, as such, reduce incentives to increase energy efficiency or shift to alternative energy sources. Conversely, 45% of the estimated budgetary cost is on income policies, which entail some form of monetary

(Continued on the next page)

Box (continued)

support without affecting the price of energy. Income policies are preferable as they do not interfere with price signals and thus maintain incentives to reduce demand.

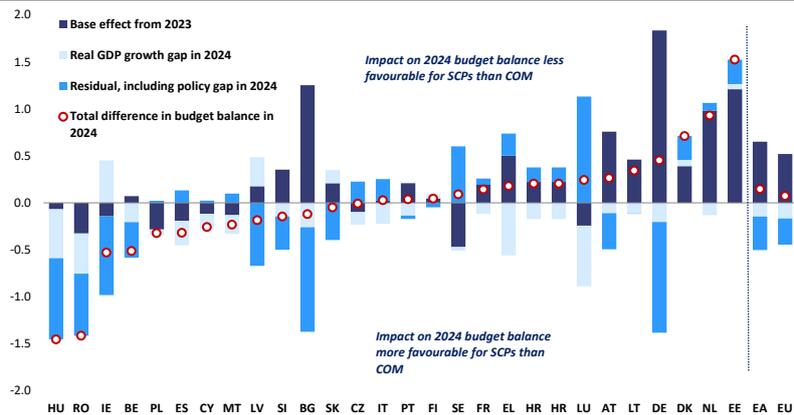
While these measures are aimed at mitigating the adverse impact of higher energy costs on households and firms, structural policies are needed to address the underlying problem of an overreliance on (imported) fossil fuels. Cushioning the immediate impact of the current high energy prices can only be 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 RePowerEU plan will help speed-up necessary investment and reforms.

Fiscal costs to support persons displaced due to the Russian invasion of Ukraine are projected to fall compared to 2022 and are concentrated in the Member States close to the region. These budgetary costs are projected by the Commission at 0.08% of GDP in 2023 in the EU, compared to 0.15% of GDP in 2022. These costs are concentrated among Member States in geographical proximity to the conflict, with four Member States (Estonia, Latvia, Lithuania and Finland) having projected budgetary costs at or above 0.3% of GDP, while these costs are set to decline in Poland to 0.2% of GDP in 2023, from 0.5% in 2022 (Table AII.10 in Annex).

2.2.3. Budgetary projections for 2024

In 2024, the EU aggregate deficit is planned to fall to 2.5% of GDP in the SCPs, broadly in line with the Commission’s no-policy-change forecast of 2.4% of GDP. Energy support measure are set to be almost fully phased out next year, while interest expenditure is projected to increase slightly (Table AII.7 in Annex). At the country level, in 2024 the SCPs plan lower budget balances than the Commission forecast - based on unchanged policies - of 0.5% of GDP or more for Denmark, the Netherlands and Estonia, whereas for Hungary, Romania, Ireland and Belgium the SCPs plan higher budget balances of 0.5% of GDP or more (Graph 2.4). Eight EU countries are still expected to have deficits above 3% of GDP in 2024, based on the SCPs, and ten based on the Commission forecast (Table AII.4 in the Annex).

Graph 2.4: Drivers of differences in budget balance projections for 2024; SCPs vs COM (% of GDP)



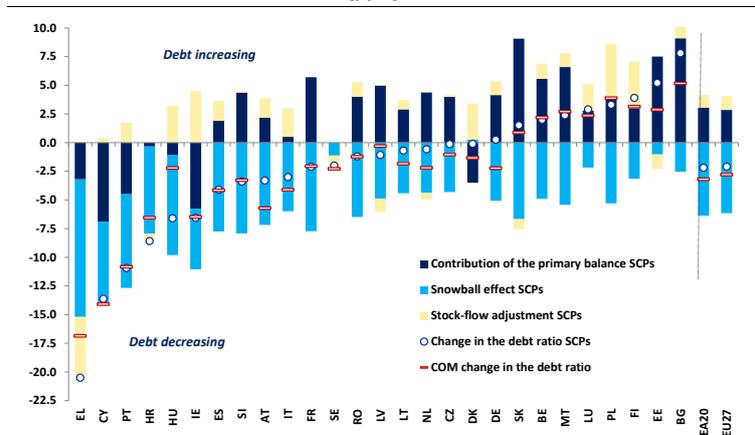
Note: The graph shows a decomposition of the difference between the budget balance figures for 2024 between the SCPs and Commission forecast into (i) the base effect related to the differences in the 2023 budget balance projections, (ii) difference in a standardised measure of the growth gap and (iii) a residual. The growth gap is calculated multiplying the difference in real growth assumptions times the standard semi-elasticities. The residual includes the "policy gap", i.e. the difference in the evaluation of budgetary measures (only those already sufficiently specified in the case of COM) as well as possible differences in revenue elasticities or interest expenditure.

Source: European Commission 2023 spring forecast (COM) and 2023 SCPs

Despite the rather strong post-pandemic recovery, budget balances in 2024 are planned to remain below 2019 (pre-pandemic) levels in all EU countries, with the notable exceptions of Ireland and Cyprus (Graph 2.3). This points to the permanent nature of some of the deficit-increasing policies implemented since the outbreak of the pandemic, which is corroborated by the overall expansionary stance of national budgets in 2020-24, in part related to higher nationally financed public investment. ⁽¹⁹⁾

2.2.4. Debt projections for 2023-24

Graph 2.5: Cumulative change in the debt-to-GDP ratio in 2023-24; COM vs SCPs, with SCPs' drivers (pps.)



Source: European Commission 2023 spring forecast (COM) and 2023 SCPs

The aggregate EU debt-to-GDP ratio is projected to decrease further in 2023 and 2024. On the basis of the SCPs, the EU aggregate debt-to-GDP ratio is projected to fall by around 1 pp. in both 2023 and 2024, to reach around 83% at the end of 2024 (around 91% for the euro area). The Commission 2023 spring forecast projects a slightly stronger reduction, to around 82% in 2024 (90% for the euro area). Over 2023-24, both the SCPs and the Commission forecast project falls in the debt-to-GDP ratios in the majority of EU countries

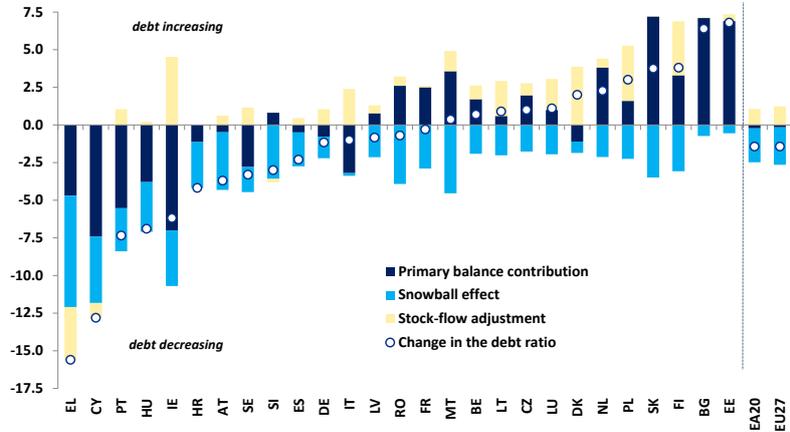
(Graph 2.5), driven by debt-decreasing snowball effects as nominal GDP growth is set to remain higher than the implicit interest rates paid on debt ($r < g$) in all countries but Denmark. Declines in the debt ratio of more than 10 pps. are projected in Greece (21 pps.), Cyprus (14 pps.) and Portugal (11 pps.) thanks to the sizeable debt-decreasing snowball effect and in part to the projected primary surpluses. At the end of 2024, the SCPs project debt ratios above 60% of GDP in 12 EU countries, six of which would still have a debt ratio over 100% of GDP (Belgium, Greece, France, Spain, Italy and Portugal. Table AII.6 in Annex). The updated assessment of risks to debt sustainability based on the Commission 2023 spring forecast is presented in Annex I.

2.2.5. Member States' fiscal plans for the medium term, 2025-26

In 2026, deficits are planned to not exceed 3% of GDP in 23 Member States' SCPs. Bulgaria, Slovakia, Estonia, and France are the only four EU countries that project a deficit above 3% of GDP in 2026 (for Slovakia the SP indicates a deficit target below 3% of GDP by 2026, but the measures needed to reach it will be presented only after the early general elections to be held on 30 September 2023). In addition to these four countries, Malta, Belgium and Finland also plan a deficit in excess of 3% of GDP in 2025. As a result of the fiscal adjustments that are planned in the SCPs, the EU aggregate deficit would further decrease in 2025 and 2026, to 2.0% and 1.7% of GDP, respectively. (Table AII.4 in Annex).

⁽¹⁹⁾ For the EU aggregate, the fiscal stance financed by national budgets in 2020-24 is estimated to be expansionary by close to 2% of GDP, of which 0.3 pps. is due to higher public investment, based on the no-policy-change Commission forecast. Over the same period, the change in the structural primary balance shows a smaller expansion, of 1.1% of GDP, with the difference largely explained by revenue windfalls. At the country level, in 2020-24, the fiscal stance financed by national budgets is estimated to be more expansionary than 2% of GDP in 13 EU countries (Belgium, Germany, Greece, Spain, France, Italy, Netherlands, Austria, Portugal, Slovenia, Slovakia, Croatia and Bulgaria).

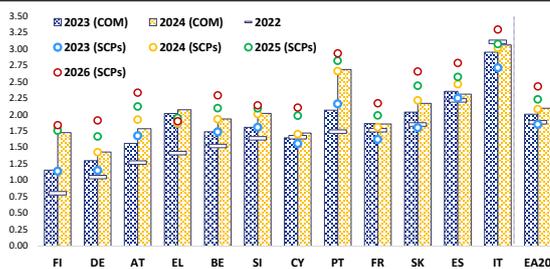
Graph 2.6: Cumulative change in the debt-to-GDP ratio projected in SCPs for 2025-26 and drivers (pps.)



Source: 2023 SCPs

In 2025-26, the SCPs project further decreases in the debt-to-GDP ratio in 15 countries (Graph 2.6). The EU aggregate is projected to decline by only 1.4 pps., to around 82% of GDP (around 89% for the euro area) in the SCPs. The ‘snowball’ effect would continue to have a debt-decreasing impact, as the interest-growth rate differential is expected to remain favourable in all Member States ($r < g$), although significantly smaller than in previous years, mainly due to lower inflation and higher implicit interest rates paid on public debts. ⁽²⁰⁾ At the same time, the EU primary balance is projected to turn positive in 2026, providing an overall marginal debt-decreasing impact in 2025-26. However, the primary deficits planned in the SCPs would continue to weigh on debt developments in 15 Member States, including Belgium and France, for which the SPs project a debt ratio still above 100% of GDP at the end of 2026. The SCPs also project the debt-to-GDP ratio to remain above 100% at the end of 2026 in Greece, Spain and Italy, and above 60% in Cyprus, Germany, Austria, Portugal, Slovenia, Slovakia and Finland (Table AII.6 in Annex).

Graph 2.7: Implicit interest rate paid on public debts in selected EU countries, COM vs SCPs; 2023-26 (%)



Note: The implicit interest rate is computed based on interest expenditure in year t and debt level at the end of year $t-1$.

Source: Commission 2023 spring forecast (COM) and 2023 SCPs

The cost of servicing public debts is projected to gradually increase over the SCPs horizon. Higher interest rates on new issuances of government bonds will gradually feed into higher implicit interest rates paid on public debts (Graph 2.7). The latter are reflected in further increases in interest expenditure projected in the SCPs, from 1.6% of GDP in 2022 to 2.0% in 2026, for the EU aggregate, despite a lower debt ratio (see also Box 3.1).

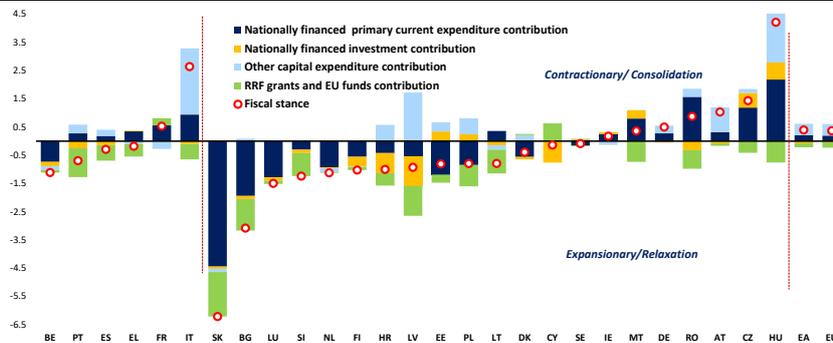
⁽²⁰⁾ See footnote 9.

2.3. FISCAL STANCE ACROSS MEMBER STATES

2.3.1. Fiscal stance in 2023

Fiscal stance projections for 2023 are very heterogeneous across countries.⁽²¹⁾ Based on the Commission forecast, which incorporates available information in the SCPs, the fiscal stance (Graph 2.8) is set to range from a contractionary stance of more than 4% of GDP in Hungary to an expansionary stance of more than 6% in Slovakia in 2023. Primary current expenditure financed by the national budgets - net of discretionary revenue measures - is expected to provide contractionary or expansionary contributions to the 2023 fiscal stance in a similar number of EU countries. Other capital expenditure is set to provide contractionary contributions of more than 2% of GDP in Italy and Hungary in 2023, after the sizeable expansions recorded in 2021-22. Finally, in the majority of Member States, spending financed by RRF grants and other EU funds is projected to provide a further expansionary contribution in 2023.

Graph 2.8: Fiscal stance in 2023 and components



Note: the graph shows the stance of high debt countries on the left, of low/medium debt countries in the centre and the EA and EU stance on the right.

Source: European Commission 2023 spring forecast

The contribution of net primary current expenditure to the 2023 fiscal stance is set to be driven by the phasing out of energy support measures in several Member States.⁽²²⁾ Primary current expenditure financed by national budgets - net of discretionary revenue measures - is expected to provide contractionary contributions to the 2023 fiscal stance in all six high-debt countries excluding Belgium. After excluding the phasing out of energy support measures, only France among the six high-debt countries shows a contractionary contribution to the fiscal stance from net primary current expenditure in 2023 (Graph 2.9).⁽²³⁾ After excluding changes in energy support measures, net primary current expenditure is set to make a sizeable expansionary contribution to the fiscal stance in several low- and medium-debt Member States. These developments may be explained by a delayed impact on public

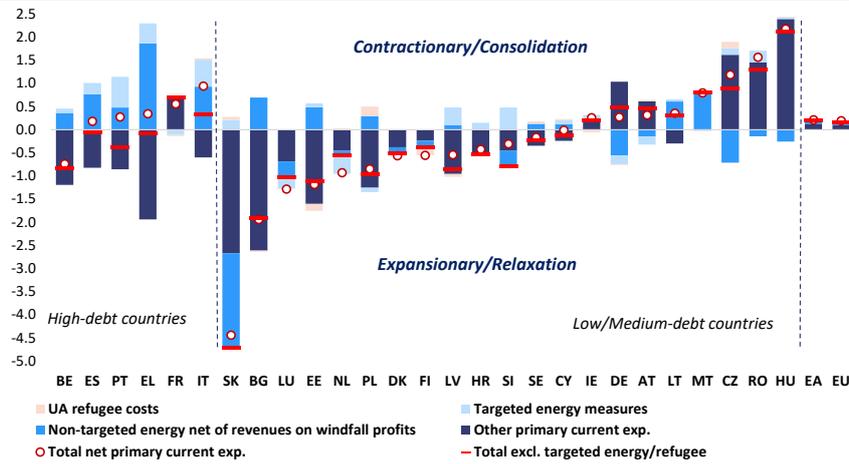
⁽²¹⁾ For a definition of the fiscal stance currently used by the Commission see footnote 12. Fiscal stance estimates are based only on the Commission 2023 spring forecast because the 2023 SCPs do not provide figures on COVID-19 temporary emergency measures, which are excluded from the fiscal stance computed by the Commission. The cost of energy support measures, which is needed for a more in-depth analysis of the fiscal stance, is also not always available in the 2023 SCPs.

⁽²²⁾ The Council's fiscal CSRs of 12 July 2022 are differentiated based on Member States' debt levels. In 2023, high-debt countries (Belgium, Greece, Spain, France, Italy and Portugal) should ensure a prudent fiscal policy, in particular by limiting the growth of nationally financed primary current expenditure below medium-term potential output growth. The other low- or medium-debt Member States should ensure that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance. In both cases, the assessment of compliance with the fiscal guidance should take into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. All Member States were asked to stand ready to adjust current spending to the evolving situation. They were also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility (RRF) and other Union funds.

⁽²³⁾ When considering only the phasing out of targeted energy support measures as well as costs to shelter and integrate people fleeing Russia's war against Ukraine, only Belgium and Portugal would show a slightly expansionary contribution in 2023 (red marker in Graph 2.9).

expenditure of very high inflation recorded in 2022, for example due to the lagged indexation of pensions and other social transfers (see also Box 1.1).

Graph 2.9: **Nationally financed net primary current expenditure, contribution to the fiscal stance and drivers in 2023**



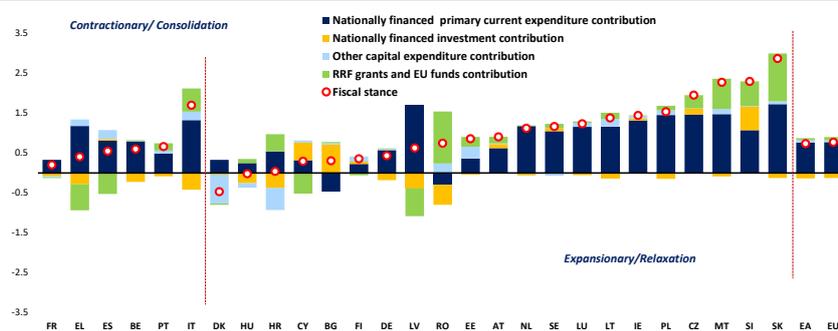
Note: the graph shows the stance of high debt countries on the left, of low/medium debt countries in the centre and the EA and EU stance on the right.

Source: European Commission 2023 spring forecast

2.3.2. Fiscal stance in 2024

Almost all EU countries are set to have a contractionary fiscal stance in 2024. Based on unchanged policies, the Commission 2023 spring forecast projects a slightly expansionary fiscal stance (red dot in Graph 2.10) only in Denmark (due to lower capital transfers; Graph 2.10), and a broadly neutral stance in France, Hungary and Croatia. The contractionary fiscal stance in other EU countries is largely driven by primary current expenditure financed by the national budgets - net of discretionary revenue measures - as energy support measures are expected to be phased out. Based on the Commission forecast, expenditure financed by RRF grants and other EU funds is projected to provide a further expansionary contribution in 2024 in only Greece, Spain, Cyprus and Latvia.

Graph 2.10: **Fiscal stance in 2024 and components**



Note: the graph shows the stance of high debt countries on the left, of low/medium debt countries in the centre and the EA and EU stance on the right.

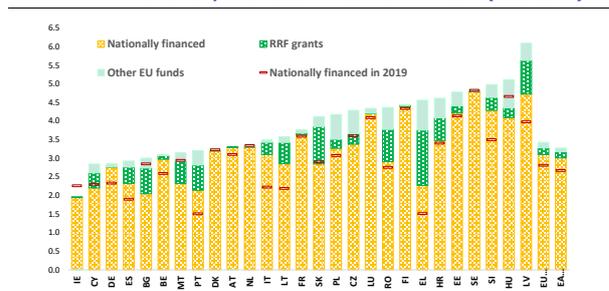
Source: European Commission 2023 spring forecast

2.3.3. Public investment in 2024

Public investment financed by national budgets is expected to remain stable or increase in most EU countries in 2024. The Commission 2023 spring forecast projects, based on unchanged policies, that

nationally financed investment (Graph 2.10) will provide a neutral or expansionary contribution to the fiscal stance in most Member States in 2024, with the exception of Cyprus, Bulgaria and Slovenia, which show a contractionary contribution from this component. ⁽²⁴⁾

Graph 2.11: Public investment in 2024 by financing source; nationally financed investment in 2019 (% of GDP)



Source: European Commission 2023 spring forecast

RRF and other EU funds are supporting the increase in high-quality public investment in Europe. High-quality public investment and reforms are needed to boost the EU's growth potential and ensure a sustainable and inclusive recovery. ⁽²⁵⁾ Public investment in the EU is expected to rise to 3.4% of GDP in 2024 (Graph 2.11), from 3% of GDP in 2019. In 2024, 17 EU countries are projected to spend the same share of GDP or more on nationally financed public investment than they did prior to the pandemic. Italy, Greece, Slovenia, Lithuania and Latvia are the countries with the largest projected increases.

2.4. ABSORPTION OF GRANTS FROM THE RECOVERY AND RESILIENCE FACILITY IN 2021-26

RRF grants are contributing to a sustainable and sustained recovery. ⁽²⁶⁾ Based on general government ESA2010 data, absorption of RRF grants in the EU increased to 0.3% of GDP in 2022 (from 0.2% in 2021). This absorption remained in most cases lower than envisaged in 2022 SCPs, especially in the case of Greece, Portugal, Romania and Slovakia, Spain. ⁽²⁷⁾

Based on the Commission 2023 spring forecast, RRF-grant absorption is set to increase further in 2023, to 0.4% of GDP, and to broadly stabilise in 2024. Over the 2021-24 period, expenditure financed by RRF grants is projected in the Commission forecast to be above 3.5% of GDP in cumulative terms in Spain and Greece, more than 3% in Croatia and Portugal, around 2.5% in Slovakia and Italy, around 2% in Latvia, Bulgaria and Romania, close or above 1.5% in Lithuania, Poland, Hungary, Cyprus and Czechia, and more than 1% in Slovenia, Malta, Estonia, and France (cumulative bars in Graph 2.12). In the same 2021-24 period, the SCPs (light blue marker in Graph 2.12) project a stronger absorption (by more than 0.1% of GDP) in Slovenia, Greece and especially Spain. By contrast, the SCPs' projections are lower than the Commission forecast (by more than 0.1% of GDP) for France, Latvia, Bulgaria and Slovakia.

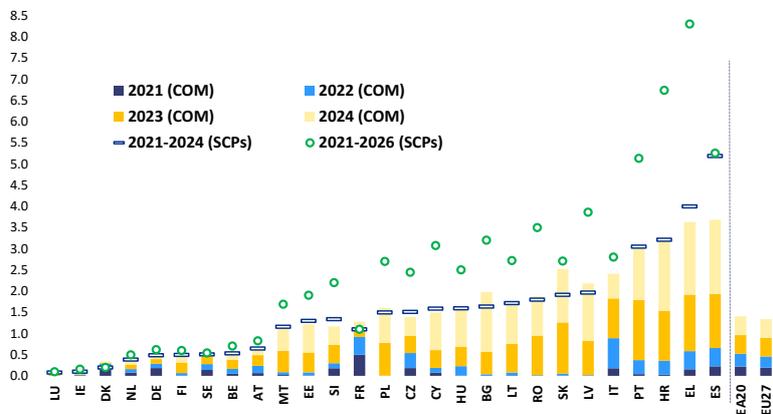
⁽²⁴⁾ Small contractionary contributions (0.1% of GDP) from nationally financed investment are also projected in Finland, Austria, Sweden, Ireland and Czechia.

⁽²⁵⁾ In their Recovery and Resilience Plans, Member States put forward a number of growth-enhancing reforms and investments, allocating almost 40% of the projected spending to climate measures and more than 25% to the digital transition. This exceeds the agreed targets of 37% for climate and 20% for digital spending. Thanks to the additional investment related to NGEU/RRF, which is overall estimated at around 4% of the EU GDP over the 6-year period 2021-2026, EU real GDP is projected to be around 1.2% higher in 2026 than in a no-policy change baseline. These results do not include the impact of reforms put forward by Member States in their Recovery and Resilience Plans (see Pfeiffer P., Varga J and in 't Veld J. (2022). "Quantifying spillovers of coordinated investment stimulus in the EU." Macroeconomic Dynamics - Publisher Cambridge University Press <https://doi.org/10.1017/S1365100522000487>)

⁽²⁶⁾ RRF-related expenditure is a key driver of public and private investment that contribute 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. For more information see https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility_en

⁽²⁷⁾ For Spain, the figures in the SP are based on cash disbursements at central government level.

Graph 2.12: RRF grants absorption across Member States COM vs SCPs (% of GDP)



Source: Commission 2023 spring forecast and 2023 SCPs

Absorption of RRF grants is set to further increase in the coming years. Looking at the medium term, the SCPs’ projections up to 2026 (green dot in Graph 2.12) show a cumulative contribution to investments and reforms by RRF grants of more than 2% of GDP in 15 EU countries (Bulgaria, Croatia, Czechia, Cyprus, Greece, Hungary, Italy, Latvia, Lithuania, Poland, Portugal, Romania, Slovenia, Slovakia and Spain).

2.5. FISCAL RECOMMENDATIONS FOR 2024

The Commission has proposed quantitative fiscal country-specific recommendation (CSRs) for 2024, as the general escape clause of the Stability and Growth Pact (SGP) is deactivated.⁽²⁸⁾ These fiscal CSRs are fully consistent with the current SGP legislation, considering to the extent possible some elements of the legislative reform package proposed by the Commission on 26 April 2023, which is now discussed by the relevant legislators.⁽²⁹⁾ In particular, the fiscal effort requirements for 2024 are modulated around the benchmark structural balance adjustment of 0.5% of GDP that the preventive arm of the SGP prescribes for countries that are not expected to be at (or close to) their medium-term objectives (MTOs) in 2023.⁽³⁰⁾ This modulation is differentiated on the basis of Member States’ public debt challenges and takes into account whether a country is projected to have a deficit above 3% of GDP in 2023. The fiscal CSRs are then formulated in terms of the maximum increase in primary expenditure financed by the national budgets – net of discretionary revenue measures – consistent with the single operation indicator that the Commission has proposed for the new EU legal fiscal framework. Importantly, all EU countries are invited to wind down energy support measures by the end of 2023.⁽³¹⁾ In 2024, all Member States are also invited to preserve nationally financed public investment and ensure the effective absorption of RRF grants and other EU funds, in particular to foster the green and digital transitions.

⁽²⁸⁾ See https://commission.europa.eu/publications/2023-european-semester-country-specific-recommendations-commission-recommendations_en

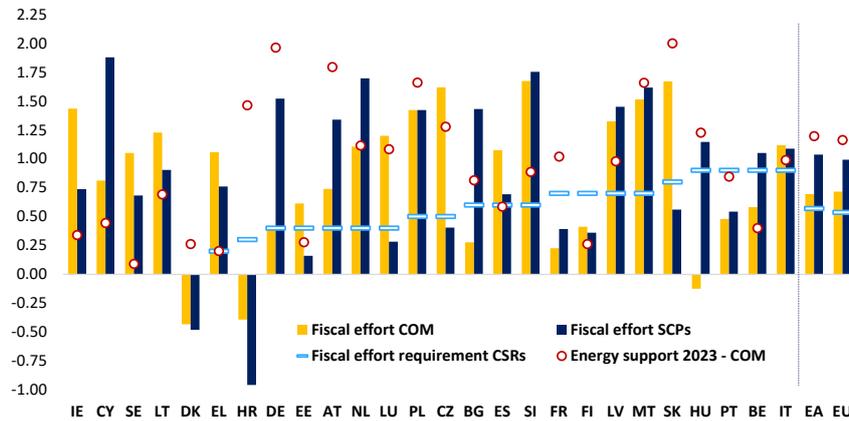
⁽²⁹⁾ See https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/economic-governance-review_en

⁽³⁰⁾ This implies that Denmark, Ireland, Cyprus, Lithuania and Sweden have not received a quantitative recommendation and have been asked to maintain a sound fiscal position in 2024.

⁽³¹⁾ The CSRs also indicate that if renewed energy price increases necessitated new support measures, Member States should ensure that these measures are targeted at protecting vulnerable households and firms, fiscally affordable, and preserve incentives for energy savings.

Most Member States appear to be on track to comply with the fiscal effort required in 2024 by the CSRs. ⁽³²⁾ Based on the no-policy-change Commission forecast (Graph 2.13), the fiscal effort falls short of the one recommended in the CSRs in seven countries (Croatia, Bulgaria, France, Finland, Hungary, Portugal and Belgium). The full phasing out in 2024 of the energy support measures impacting on 2023 and the use of the related savings to reduce the government deficit, which is recommended unless renewed energy price increases necessitate new support measures, would allow most Member States to be compliant with the recommended fiscal effort, based on the Commission forecast's estimates. The only countries for which the recommended fiscal effort is higher are Belgium, Finland and, to a lesser extent, Estonia and Portugal. The fiscal efforts planned for 2024 in the SCPs, ⁽³³⁾ which in some cases reflect different projections for energy measures implemented in 2023 ⁽³⁴⁾ and then phased out in 2024, would not be sufficient to comply with the recommended fiscal effort in eight Member States (Croatia, Estonia, Luxembourg, Czechia, France, Finland, Slovakia and Portugal). An assessment of compliance with the required fiscal effort in 2024 will be carried out in Autumn 2023 on the basis of the draft budgetary plans.

Graph 2.13: **Fiscal efforts in 2024 based on net primary expenditure; COM and SCPs vs CSRs and energy support in 2023 (% of GDP)**



Source: European Commission 2023 spring forecast (COM), 2023 SCPs and fiscal Country-specific recommendations for 2024

⁽³²⁾ Romania is not considered in this analysis as it is under EDP and has received a different CSR for 2024 (Romania should pursue fiscal policies in line with the Council Recommendation of 18 June 2021 with a view to bringing an end to the situation of an excessive government deficit by 2024).

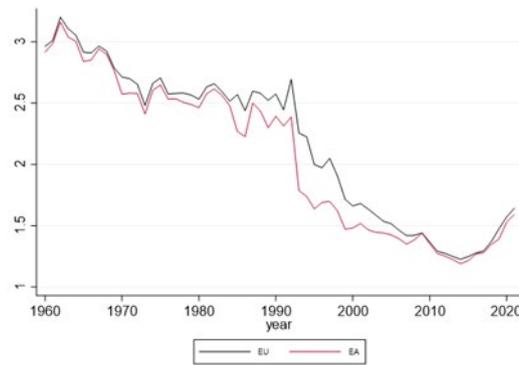
⁽³³⁾ For some Member States, the budgetary projections in the SCPs are essentially forecasts, rather than targets (see also footnote 3).

⁽³⁴⁾ Czechia and Latvia classified energy support measures as one-offs, which is not in line with the Commission's guidance.

Box 2.3: Defence spending in the EU: information from the SCPs

Defence spending⁽¹⁾ in the EU has been increasing since 2014, following a decreasing trend during the previous five decades (Graph 2b). This decrease was most pronounced during the 1990s on account of the so-called peace dividend following the end of the Cold War. The terrorist attacks of 2001 and subsequent wars in Afghanistan and Iraq were key events that led to a gradual levelling-off of the trend decline in spending. While the need for fiscal consolidation in some countries in the aftermath of the Global Financial Crisis led to a further significant decline in defence spending, the illegal annexation of the Crimean Peninsula by the Russian Federation in 2014 put defence expenditure in the EU on an upward trend. A further boost to defence spending came from the Russia's war of aggression against Ukraine in February 2022.

Graph 2b: Military spending in the EU and euro area (% of GDP)



Source: Stockholm International peace research institute

As a result of the Russian invasion of Ukraine in February 2022, most EU Member States have increased their defence budgets and further increases are set out in the 2023 Stability and Convergence Programmes (SCPs). Three groups of countries can be distinguished based on the information provided in the SCPs.

- 1. Member States that quantify future defence spending in the dedicated COFOG table.** This group consists of 11 countries. Except for Malta and Cyprus, these countries plan to boost defence spending over the SCPs horizon (Graph 2c), especially in Czechia and Finland. More specifically:
 - Czechia plans to increase its annual defence expenditure by 1 pp. of GDP in 2026 compared to 2021. This is consistent with the 'Defence Financing Bill', which requires national defence expenditure to reach at least 2% of GDP annually starting with the 2024 State Budget.
 - Finland plans an increase in defence expenditure of 0.7 pps. of GDP by 2026. EUR 11 billion is already budgeted for 2022 and 2023 and allocated to the spending limits for the period 2024–2027 by the national 'Security Policy Escape Clause'. New costs are also expected as a result of NATO membership (EUR 50-65 million per year).

⁽¹⁾ According to the COFOG definition, defence spending includes: military defence, civil defence, foreign military aid, R&D defence and other.

(Continued on the next page)

Box (continued)

The Netherlands, Estonia and Spain plan increases in defence spending by 2026 of 0.5 pps., 0.4 pps. and 0.3 pps. of GDP, respectively. The remaining countries for which COFOG projections are available (Slovakia, Latvia, Luxembourg and Bulgaria) plan an increase of less than 0.2 pps. of GDP by 2026.

Graph 2c: Defence expenditure planned in the SCPs; 2026 vs 2021 (COFOG; % of GDP)



Source: 2023 SCPs

2. **Member States that only mention a future budgetary impact of defence spending in the text, without any quantification in the dedicated COFOG ⁽²⁾ table. ⁽³⁾** There are eight EU countries in this group:

- Austria: a national defence package with a budgetary impact in 2024-26.
- Croatia: budgetary projections reflect the strengthening of defence capabilities and security.
- Italy: new budgetary resources that will be dedicated to the modernisation of national defence.
- Sweden: the Spring Amending Budget Bill for 2023 includes measures to boost defence and emergency readiness in order to ensure quick admission to NATO after Sweden's accession protocol has been accepted.
- Denmark: emphasis on the necessity for more spending to address current security problems.
- Germany: large rise in defence funding in the 2023 budget and the fiscal plans until 2026. The SP also indicates that in 2022 a special fund (worth €100 billion) was established to bolster alliance and defence capabilities.
- Lithuania: the government has revised the 2022 budget in order to increase defence spending by 0.5% of GDP.
- Poland: the Act of 11 March 2022 on the Defence of the Homeland boosted national defence expenditure from the budgeted 2.2% of GDP in 2022 to 3% beginning in 2023. Defence spending is predicted above 3% of GDP over the forecast horizon.

⁽²⁾ The Classifications of the Functions of Government (COFOG), developed by the OECD in 1999, classifies government expenditures by the purpose for which the funds are used.

⁽³⁾ The SCP table, collecting data on the total expenditures by function, is a non-mandatory table according to the Code of Conduct of the SGP.

(Continued on the next page)

Box (continued)

3. **There is no mention of future defence spending in the SCPs⁽⁴⁾.** This group is made up of eight countries (Belgium, Greece, France, Ireland, Hungary, Romania, Portugal, Slovenia).

A reference to the necessity to comply with international commitments emerges in five SCPs (Italy, Germany, Czechia, Spain and Denmark), three of which (Spain, Czechia and Denmark) allude to a NATO commitment of 2014 to reach a minimum spending of 2% of GDP. Denmark expects to reach this commitment by 2033.

As a result, EU defence spending can be expected to rise in the medium term, although it is difficult to say of how much at this stage.

⁽⁴⁾ The absence of a reference to this topic in the SCPs does not preclude the existence of this information in other official documents. For instance, in France the 2023 budget law allocates EUR 53.1 billion to defence spending (see Law n° 2022-1726 of December 30, 2022 on finances for 2023, article 131, statement B), i.e. 1.9% of GDP, while the Parliament is discussing a draft law on military programming for the years 2024-2030 (see https://www.assemblee-nationale.fr/dyn/16/textes/116b1033_projet-loi#).

3. EURO AREA FISCAL STANCE AND THE POLICY MIX

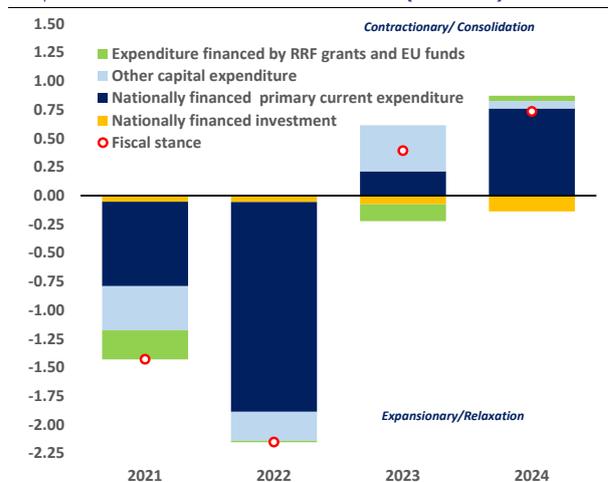
This section focuses on the aggregate euro area fiscal stance and its interaction with monetary policy (i.e., the policy mix).⁽³⁵⁾ The policy mix is particularly relevant for the euro area, where a single monetary policy and national fiscal policies must provide adequate responses to common and idiosyncratic economic developments and shocks. A more detailed discussion of the fiscal stance across euro area Member States is covered in sections 1.3 and 2.3.

An appropriate fiscal policy in the euro area is needed not to fuel current high inflationary pressures further and to ensure sustainable and sustained growth going forward. It is particularly important that inflation expectations continue to remain well anchored to the ECB's 2% target and that national fiscal policies reflect the need to avoid any spiralling price dynamics. In a context of persistently high core inflation, lower energy prices and monetary policy normalisation, fiscal policy in the euro area is now contractionary, after the sizeable fiscal expansion of 2020-22. The stance is expected to become more contractionary in 2024, driven by the projected near full phasing out of temporary energy support measures by the end of 2023.

3.1. EURO AREA FISCAL STANCE IN 2022-24

The euro area fiscal stance was significantly expansionary in 2022, at around 2¼% of GDP (Graph 3.1). As seen in Graph 3.1, this followed an overall expansionary stance estimated at around 1¾% of GDP for 2020-21. Primary current expenditure - net of discretionary revenue measures - financed by national budgets contributed significantly to the 2022 expansionary fiscal stance, in particular due to the energy support measures implemented by governments in response to energy price hikes (Box 2.2; Table AII.8 in Annex). A significant expansionary contribution came also from other capital expenditure, which increased further in 2022 (following the strong increase in 2021). This was mainly related to governments' subsidies to private investment in Italy.⁽³⁶⁾ Nationally financed investment provided a slightly expansionary contribution to the euro area fiscal stance in 2022, whereas the contribution from expenditure financed by RRF grants and other EU funds was neutral, after an expansion in 2021.⁽³⁷⁾

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



Source: European Commission 2023 spring forecast

A slightly contractionary fiscal stance is projected for 2023, close to ½% of GDP. This is mainly related to the reversal of subsidies to private investment (especially in Italy), reflected in the contractionary contribution to the fiscal stance from other capital expenditure (Graph 3.1). Primary current expenditure - net of discretionary revenue measures - is also expected to provide a slightly contractionary contribution to the euro area fiscal stance, also due to the expected small reduction in energy support measures (Graph 3.2). By contrast, higher expenditure financed by RRF grants and other EU funds, and investment financed by national budgets are both set to provide slightly expansionary contributions to the euro area fiscal stance in 2023.

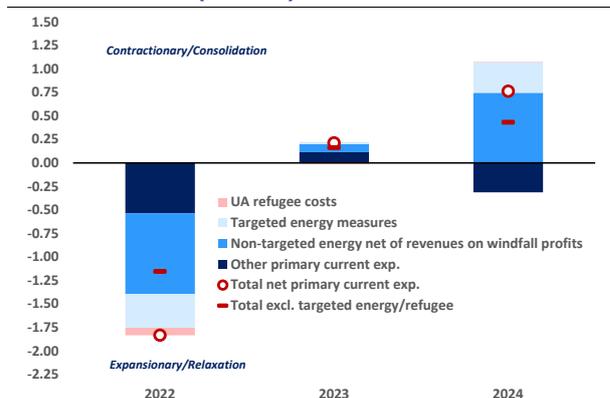
⁽³⁵⁾ For a definition of the fiscal stance currently used by the Commission see footnote 12.

⁽³⁶⁾ See footnote 8.

⁽³⁷⁾ The support of the EU budget to investments (and reforms), especially through the RRF, provides a boost to aggregate demand, but also lead to persistent productivity improvements and thus lower inflationary pressures in the medium term.

The euro area fiscal stance is projected to be contractionary in 2024, by around ¾% of GDP, based on unchanged policies. This contractionary stance is driven by the announced phasing out of almost all

Graph 3.2: **Nationally financed net primary current expenditure, contribution to the euro area fiscal stance and drivers (% of GDP)**



Source: European Commission 2023 spring forecast

energy support measure driving the contractionary contribution from net primary current expenditure (Graph 3.1). Nevertheless, the contractionary contribution of this net primary current expenditure is smaller than that mechanically resulting from the phasing out of (targeted and untargeted) energy support measures (dark bar in Graph 3.2), due to a delayed impact of inflation on some expenditure items, as well as higher subsidies and tax cuts in some Member States. ⁽³⁸⁾ Some small contractionary contributions to the euro area fiscal stance also come from expenditure financed by the EU budget and other capital expenditure, whereas investment financed by national budgets is the only component projected to provide a slightly expansionary contribution next year.

The recommended phasing out of temporary energy support measures by the end of 2023, using the related savings to reduce government deficits, implies a contractionary euro area fiscal stance of around 1¼% of GDP in 2024. As mentioned above, while the no-policy-change Commission forecast for 2024 actually expects a phasing out of energy support measures, projection also incorporates a still significant increases in other primary expenditure - net of discretionary revenue measures - in some Member States. The quantitative fiscal effort requirement included in the CSRs for 2024 at face value, i.e. without considering the recommended phasing out of energy measures, would imply a contractionary fiscal stance of just above ½% of GDP (Graph 2.13).

Over 2020-24, the cumulative fiscal stance of the euro area is estimated to be significantly expansionary, at around 2¾% of GDP. Based on the no-policy-change Commission forecast, expenditure financed by RRF grants and other EU funds is projected to provide an expansionary contribution of 0.4 pps., while the cumulative expansionary contribution of nationally financed investment is estimated at 0.3 pps.

3.2. MONETARY POLICY STANCE IN 2022-24

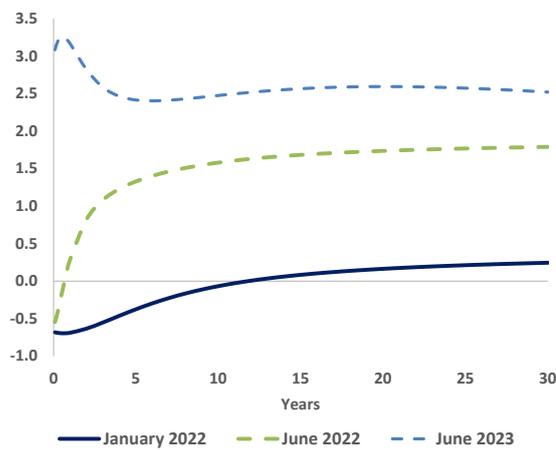
Interest rates are plateauing following the rapid monetary policy normalisation process initiated in 2022. Last year the euro area witnessed unprecedentedly high year-on-year HICP inflation, which rose from 5.1% in January 2022 to peak at 10.6% last October, in connection with high energy and food prices. Inflationary pressures prompted the European Central Bank (ECB) to adopt a series of policy normalisation measures. These have included: i) the end of net asset purchases under the Pandemic Emergency Purchase Program (PEPP) and the Asset Purchase Program (APP) in 2022, which has been followed by a continued reduction in APP holdings since March 2023; ii) an increase in policy rates of 400 bps between July 2022 and June 2023; and iii) a revision of the conditions governing the remaining targeted long-term refinancing operations (TLTRO III) to reinforce the transmission of monetary policy to bank lending. While market expectations point to further small increases in policy rates and any future

⁽³⁸⁾ This is the case in particular for Germany, Austria and to a lesser extent France and Portugal. For more information see: https://commission.europa.eu/publications/2023-european-semester-country-specific-recommendations-commission-recommendations_en

decisions will remain data dependent, the pace of increase has slowed down considerably since March 2023.

Financing conditions have tightened strongly in both nominal and real terms. One-year and ten-year

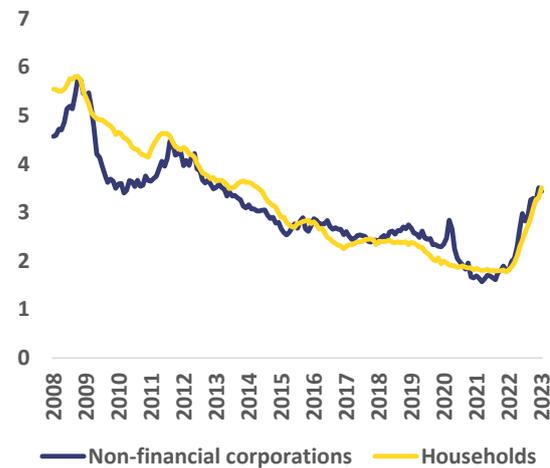
Graph 3.3: Yield curves of AAA-rated euro area sovereigns (%)



Source: ECB, own calculations

tightened significantly since the beginning of 2022, having returned to positive territory in the second half of the year (Graph 3.5). Short-term real interest rates have been temporarily compressed by a spike in inflation but are now in a process of catching up. As a result of both weaker demand and tighter lending

Graph 3.4: Composite financing cost indicators, euro area (%)



Source: ECB, Bloomberg, Datastream, own calculations

firms. Long-term real interest rates have tightened significantly since the beginning of 2022, having returned to positive territory in the second half of the year (Graph 3.5). Short-term real interest rates have been temporarily compressed by a spike in inflation but are now in a process of catching up. As a result of both weaker demand and tighter lending conditions, bank lending to firms and households has been weak since the end of the third quarter of 2022, implying negative growth in real terms given the high inflation environment.

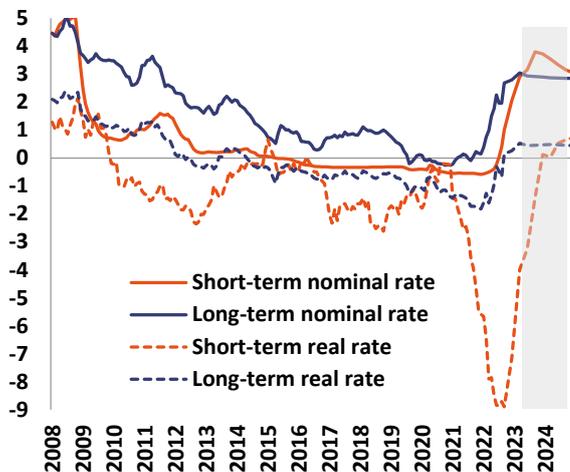
The ECB's balance sheet is expected to continue to steadily contract in 2023-24, as past bond purchases are not reinvested.

Maturing bonds held under the APP will stop being partly reinvested from July 2023, accelerating a reduction of the ECB's balance sheet that started in March 2023. At the same time, bonds held under the PEPP are expected to continue to be fully reinvested at least until the end of 2024. Moreover, at the end of June 2023 banks reimbursed a further sizeable amount of what they had borrowed under TLTRO. As regards policy interest rates, financial market participants anticipate a

further increase of 25 bps. in July 2023, followed by a partial reversal of the tightening cycle in 2024. As regards bank lending, survey evidence suggests continued tightening of credit standards for firms and households in 2023 which should reinforce the transmission of monetary policy tightening.

Risks related to persistent or higher-than-expected inflation remain and carry financial stability implications. While inflation is expected to decline to 3.6% and 2.3% in the euro area by year-end 2023 and 2024, respectively, this projection is subject to upside risks. Disinflation has, so far, been mostly driven by falling energy prices. Measures of underlying inflation have yet to show a clear turning point.

Graph 3.5: Euro area benchmark interest rates (%)



Note: Shaded period is forecast. Short term interest rate: 3-month Euribor; Long term interest rate: 10-year interest rate swap; Real interest rates are derived from the respective short or long-term interest rate minus annual HICP inflation and average future inflation inferred from 10-year inflation swaps, respectively. Short-term nominal forecasts (derived from forward short-term interest rates) are deflated by the Commission's inflation forecast. Long-term nominal interest rate forecasts (derived from forward long-term swap rates) are deflated by their respective forward inflation swaps (i.e. 1-year-10-year and 2-year-10-year forward inflation swap rates).

Source: Bloomberg, AMECO, own calculations

Ultimately, the stickiness of underlying inflation will depend on the response of domestic drivers such as wages, profit margins and the fiscal policy reaction to losses in real income. Should inflation become entrenched, there is a risk of a de-anchoring of inflation expectations and a more prolonged monetary policy tightening cycle, which carries financial stability risks. While higher interest rates have increased banks' interest rate margins from previously depressed levels, thereby boosting their profitability, they also increase the debt burden on borrowers, with negative implications for their creditworthiness and the strength of banks' balance sheets. In this context, fiscal policies should be conducted with particular care in the current context, so as to not unduly stoke inflationary pressures.

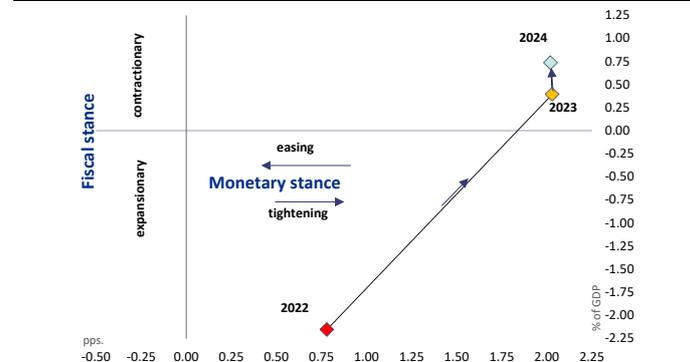
3.3. POLICY-MIX IN THE EURO AREA IN 2022-24

In 2023-24, fiscal and monetary policies in the euro area are set to work in sync. While the ECB started its tightening cycle in 2022, in the context of a rapid rise in inflation, fiscal policy was very expansionary (Graph 3.6). The policy mix for 2023 still appears skewed towards a stronger tightening effort on the part of monetary policy, part of which, however, will only be felt in 2024 due to lags in the transmission of monetary policy. In 2024, fiscal and monetary policies are expected, based on the Commission no-policy-change forecast, to work more in tandem, with fiscal policy in the euro area becoming more contractionary. The complete use of savings related to the reversal of energy support measures to reduce government deficits would imply a more restrictive fiscal policy stance in 2024, which would further facilitate the task of monetary policy.

Overall, fiscal policy in 2023-24 is not expected to fuel additional inflationary pressures in the euro area and appears broadly consistent with the ongoing tightening of monetary policy. This contractionary fiscal stance, which is subject to the timely winding down of energy support measures, appears also consistent with the need to preserve macro-financial stability and long-term debt sustainability in the euro area, considering the impact of higher real interest rates. Further contractionary fiscal stances are expected to be implemented in the euro area in subsequent years, as several Member States would need to achieve a fiscal position in the medium term consistent with a headline deficit credibly below 3% of GDP and a steady decline in high public debt ratios.⁽³⁹⁾ This will also imply a differentiation of the fiscal stances among Member States in the coming years. The end of RRF support may also lead to a contractionary impact, especially in 2027, unless governments build additional fiscal buffers during the RRF absorption period.

⁽³⁹⁾ Higher ageing-related budgetary costs will also need to be addressed.

Graph 3.6: Policy mix in the euro area; 2022-2024



Note: The monetary policy stance is based on the cumulative change in real long-term interest rates since end 2021.

Source: European commission 2023 spring forecast, Bloomberg, own calculations

A swift adoption of the new EU fiscal framework will help foster certainty and clarity about the future direction and coordination of fiscal policy in the EU. This will facilitate the achievement of a policy mix that is appropriate for a sustainable and sustained growth in the euro area and the EU as a whole.

Box 3.1: The impact of higher interest rates on the cost of servicing public debts in the EU

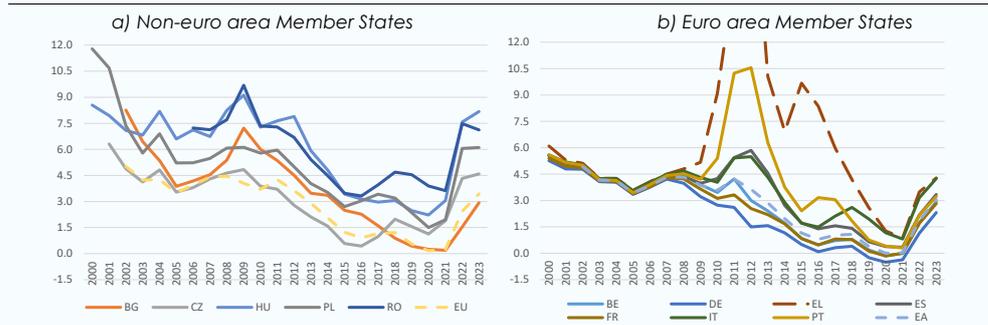
This Box presents the latest developments in market interest rates and the impact they will have on interest expenditure in EU Member States based on the Commission forecast up to 2024. When moving from that short-term scenario and considering the implications in the medium and long run, the effects may be more significant (see Annex I for a longer-term perspective).

1. RECENT DEVELOPMENTS IN MARKET INTEREST RATES

Overall developments in the EU and the euro area

Over the last year and a half, financial conditions in the EU have tightened significantly in the context of a normalisation of monetary policies due to increasing inflationary pressures. Government long-term interest rates have increased across the board in the EU from the historically low levels of 2020-21 (Graphs 3.a and 3.b). These developments in long-term market interest rates reflect market expectations of some further tightening of monetary policy in 2023, due to persistent inflationary pressures, before a gradual easing from 2024. ⁽¹⁾

Graph 3.a-b: Long-term nominal interest rates in selected EU Member States; 2000-23 (%)



Source: European Commission

In spite of the higher interest rates, governments' financing costs are expected to remain contained in 2023-24. Nominal risk-free long-term interest rates in the euro area are expected to stay at just below 3% over the 2023-24 forecast horizon. ⁽²⁾ Those levels are however higher than before the pandemic and will be gradually reflected in higher government interest expenditure.

Country-specific developments in financing conditions

Some non-euro-area Member States face significantly higher financing costs, while interest rate spreads remain broadly stable in the euro area. Hungary, Romania, Poland and Czechia (Graph 3.c) have experienced particularly strong inflation pressures, requiring a decisive policy response from the national central banks. ⁽³⁾ High risk premia also weigh on interest rates in Hungary and Romania. Besides drivers related to the catching-up process, higher inflation in these Member States (compared to the euro area average) is mainly explained by higher inflation targets, more expansionary fiscal stances, and the large food and energy price shocks, given the significant share of these items in the inflation basket and the higher energy intensity of production in these

⁽¹⁾ Commission 2023 spring forecast (https://economy-finance.ec.europa.eu/system/files/2023-05/ip200_en_1.pdf).

⁽²⁾ Beyond the short-term forecast horizon, market interest rates are expected to further increase in many Member States, as reflected by financial market expectations used in the Commission's Debt Sustainability Analysis risk framework.

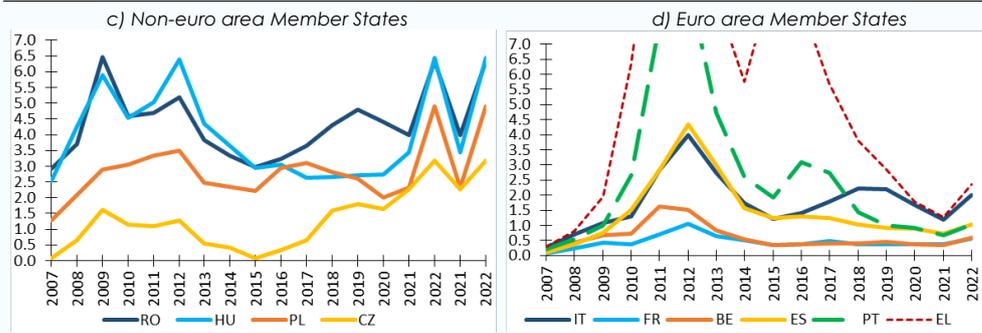
⁽³⁾ In Sweden and Denmark, the process of monetary policy normalisation is broadly aligned to that of the ECB.

(Continued on the next page)

Box (continued)

countries. High-debt euro area Member States have experienced only a limited widening of interest rate spreads. (Graph 3.d).

Graph 3.c-d: Spreads vs Germany for yields on 10-year government bonds; selected Member States (pps.)

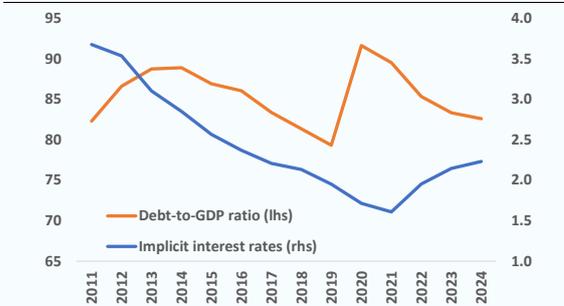


Source: European Commission based on ECB LTIR database

2. IMPACT ON IMPLICIT INTEREST RATES PAID ON GOVERNMENT DEBT

After a long trend decline, since 2021 the implicit interest rates paid on sovereign debt has been increasing in the EU (Graph 3e and Graph 2.7 in Section 2 of the paper).⁽⁴⁾ This largely reflects the rise of market interest rates discussed above.

Graph 3.e: EU public debt and implicit interest rates



Source: European Commission 2023 spring forecast

In 2022, Hungary and Poland were the Member States with the highest increase in implicit interest rates paid on public debt (1.2 pps.), followed by Czechia, and Sweden (0.9 pps.). The Commission 2023 spring forecast projects the strongest increase over 2023-24 in Estonia and Hungary (2.6 and 2.0 pps. respectively), followed by Romania, Latvia and Poland (around 1 pp.). Portugal, Finland, and Malta are also projected to register significant increases (close to 1 pp.).

In a few Member States, the share of government bonds indexed to inflation also weigh on interest expenditure. This is in particular the case for France and Italy, where in 2022 those bonds represented 10% and 11% of public debts and about one third of total interest expenditure.

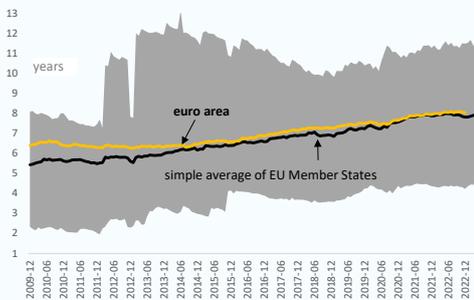
The relatively slow pass-through of higher market interest rates into costs of servicing public debts reflects a lengthening of debt maturities over time. For all EU Member States, the simple average residual maturity of public debts was around 8 years at the end of 2022 (Graph 3.f).

⁽⁴⁾ The implicit interest rate is computed based on interest expenditure in year t and debt level at the end of year $t-1$.

(Continued on the next page)

Box (continued)

Graph 3.f: Residual maturity of government debt in EU/EA



Note: The graph shows the range and simple average of residual maturities of general government debt securities in EU Member States and the euro area as a whole.

Source: ECB, European Commission

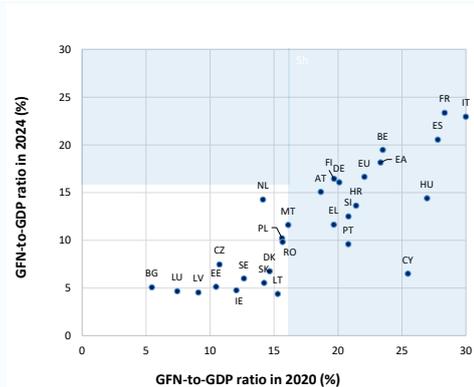
There are however some significant cross-country differences: for instance Poland, Czechia and Hungary register shorter debt maturities (between 4½ and 6½ years in 2022), which implies a quicker transmission of the increase in market interest rate into the implicit interest rates paid on public debts. Among high-debt Member States, the residual maturity of public debts at the end of 2022 was around 7 years for Italy and Portugal, 7.7 years for Spain, 8.4 years for France, 9 years for Greece and 11 years for Belgium.

The share of short-term government debt receded after the increase recorded during the COVID-19 crisis, though it is non negligible in some EU Member States. Governments with a high share of short-term debt may be relatively more exposed to increases in official interest rates and rapid changes in financial markets’ expectations. After the peak recorded during the COVID-19 crisis, the ratio of short-term debt decreased in most countries and for the EU as a whole since 2021. Seven Member States (Denmark, Finland, Germany, Ireland, Italy, Malta and Portugal), continue to have a share of short-term debt that is above the EU average of 10.6% of the total debt. Although the share of short-term debt for the EU average has decreased by 1.1 pps. since 2020, it remains above the pre-pandemic (2019) level (9.4% of the total debt).

3. GOVERNMENT GROSS FINANCING NEEDS

Despite tightening financing conditions, government gross financing needs (GFN) are projected to continue declining in the EU by 2024 (Graph 3.g).

Graph 3.g: Government gross financing needs (% of GDP, 2020 and 2024)



Note: (1) The risk threshold of around 16% of GDP has been derived based on a signalling approach. For more information see the Commission 2022 Debt Sustainability Monitor. (2) Blue quadrants depict Member States where gross financing needs exceeded this threshold in 2020 and /or 2024.

Source: European Commission (Ameco); ECB, Eurostat and ECFIN

The overall decline of GFN since the peak reached in 2020 can be explained by increasing primary balances compared to pandemic levels, indicating limited liquidity risks overall. However, gross financing needs are expected to remain sizeable in several EU countries in 2024, including Italy, France, Spain and Belgium.

ANNEX I

Debt sustainability analysis

AI.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. ⁽⁴⁰⁾ 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 over the long term) 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. ⁽⁴¹⁾

The assessment of fiscal sustainability risks is based on the latest available information. Two key inputs are used in the analysis: the Commission 2023 spring forecast (until T+2) and its medium-term extension (in particular, the T+10 GDP projections) and the 2021 Ageing Report. ⁽⁴²⁾ ⁽⁴³⁾ The projections based on the Commission 2023 spring forecast incorporate to a large extent the positive impact of investments and reforms on growth under Next Generation EU (NGEU). The Ageing Report reflects the projected cost of population ageing over the medium and long term. In line with the 2022 Debt Sustainability Monitor (DSM), the Commission baseline relies on a ‘no-fiscal-policy-change’ assumption. This implies that structural primary balances (SPBs) are assumed to be only modified by projected changes in the cost of ageing beyond 2024.

⁽⁴⁰⁾ See the Debt Sustainability Monitor for further details on the methodology: European Commission (2023), ‘Debt Sustainability Report 2022’, *European Economy, Institutional Paper* 199, April 2023, https://economy-finance.ec.europa.eu/publications/debt-sustainability-monitor-2022_en.

⁽⁴¹⁾ Medium-term debt developments are also discussed in the Commission report prepared in accordance with Article 126(3) of the Treaty (<https://economy-finance.ec.europa.eu/system/files/2023-05/Report%20in%20acc%20with%20Art126%20TFEU.pdf>). 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).

⁽⁴²⁾ 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.

⁽⁴³⁾ 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.

Table AI.1: Overall fiscal sustainability risk classification based on the Commission 2023 spring forecast

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

Note: In brackets: risk category in the 2022 Debt Sustainability Monitor, when different.

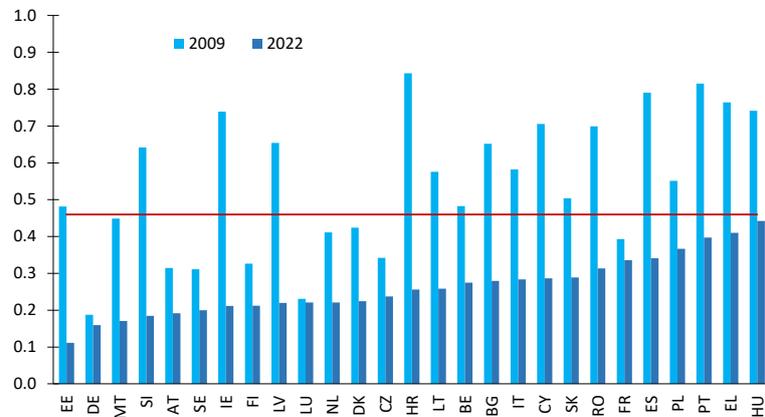
Source: European Commission

Table AI.1 summarises the Commission risk classification over the short, medium and long term based on the Commission 2023 spring forecast. The rest of the annex describes in more detail the methodology and analysis underpinning this risk classification, starting with the short term (Section AI.2) and moving on to the medium term (Section AI.3) and long term (Section AI.4).

AI.2. SHORT-TERM RISKS

Short-term fiscal sustainability risks are overall considered to be low thanks to improved public finances and unchanged macroeconomic imbalances in Member States. The Commission assesses short-term risks using its standard early-warning indicator S0, which captures both fiscal and macroeconomic vulnerabilities. According to this indicator, all Member States have values of S0 below its critical threshold, indicating overall low risk of fiscal stress in the upcoming year (Table AI.1). These results are unchanged compared with the Debt Sustainability Monitor 2022, with short-term fiscal sustainability risks having overall declined compared with the COVID-19 period.

Graph AI.1: The S0 indicator for EU countries (2009 and 2022)

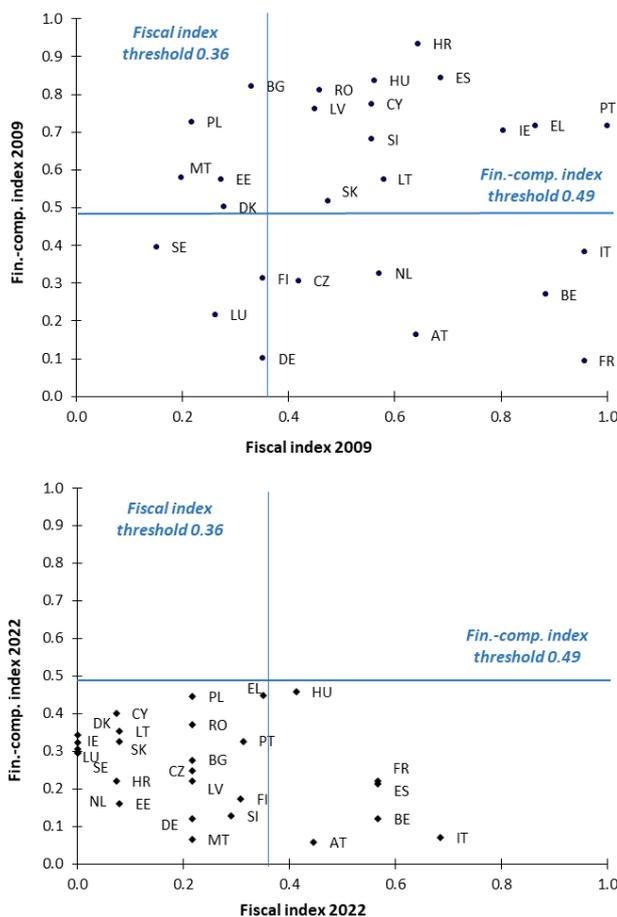


Note: For more methodological explanations, see Berti, K., Salto, M. and M. Lequien (2012), An early detection index of fiscal stress for EU countries, *European Economy – Economic Paper*, 475; Pamies Sumner, S. and K. Berti (2017), A complementary tool to monitor fiscal stress in European economies, *European Commission Discussion Paper*, 49.

Source: European Commission

Nevertheless, the S0 indicator identifies some vulnerabilities in the short term, with the fiscal sub-index pointing to some vulnerabilities in seven Member States This concerns Italy, Belgium, France, Portugal, Spain, Austria and Hungary. Fiscal vulnerabilities can be explained by a deterioration in fiscal positions in some Member States. Increasing inflationary pressures have also prompted a significant rise of central bank policy rates, contributing to some extent to higher interest spending. In addition, discretionary fiscal measures to shelter households, workers and firms from the impact of war and high energy prices are weighing on budget deficits. In some Member States, high fiscal balances further increased already high levels of government debt (e.g., Belgium, France, Spain, Greece and Italy). As a result, governments' gross financing needs, which are estimated to have fallen in 2022, are expected to remain sizeable in six Member States (Italy, France, Spain, Belgium, Austria, Germany and Finland). They are, however, expected to remain stable over the forecast horizon, also thanks to NGEU and despite the monetary policy tightening by many central banks in the EU. In addition, the short-term macroeconomic outlook is also surrounded by a high degree of uncertainty, in particular due to the effects of Russia's war of aggression against Ukraine and the energy price shock. Rising interest rates are already leading to increased interest spending, and the ECB and most other EU central banks are expected to further increase their main policy rates during the remainder of 2023. This represents a significant change in financing conditions compared with past years.

Graph Al.2: Fiscal and financial-competitiveness sub-indices (2009 and 2022)



Note: For more methodological explanations, see Berti, K., Salto, M. and M. Lequien (2012), An early detection index of fiscal stress for EU countries, European Economy – Economic Paper, 475; Pamies Sumner, S. and K. Berti (2017), A complementary tool to monitor fiscal stress in European economies, European Commission Discussion Paper, 49.
Source: European Commission

Table Al.2: Gross financing needs (% of GDP) - Member States with a signalling risk

	2020	2023	2024
BE	23.5	19.3	18.9
ES	27.8	20.2	19.6
FR	28.0	22.7	22.5
IT	29.9	23.9	23.4
FI	19.2	16.1	17.1
EA	23.1	17.8	17.0
EU	21.9	16.4	15.7

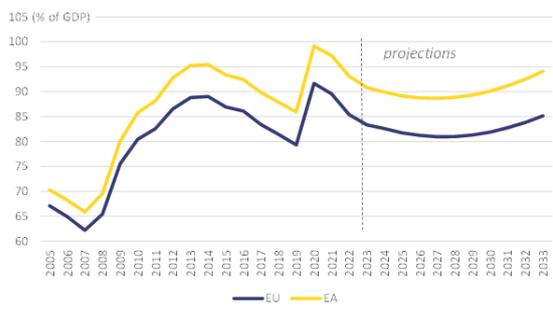
Note: The threshold of around 16% of GDP is considered as signalling risks based on the signalling approach. For more information on the methodology, see the 2022 Debt Sustainability Monitor.

Source: Ameco

AI.3. MEDIUM-TERM RISKS

The Commission ‘no-fiscal-policy-change’ baseline shows a temporary debt reduction until the late 2020s, although with large cross-country differences

Graph AI.3: Medium-term baseline debt projections, EU and EA

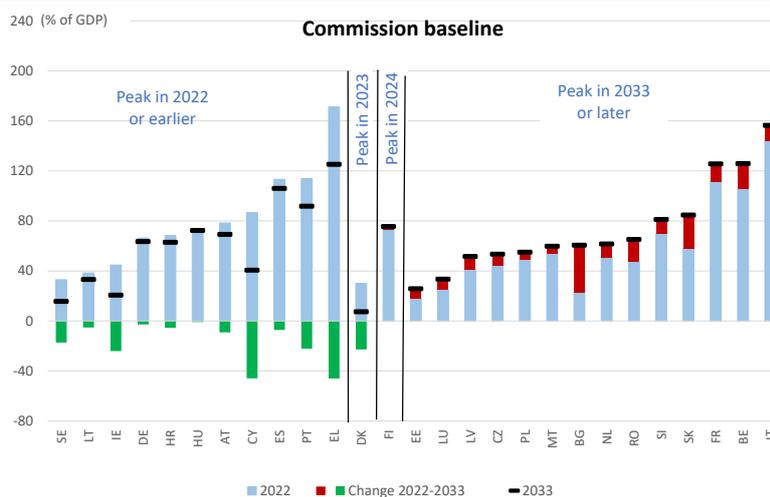


Note: These projections are based on the Commission's Spring forecast 2023. The Commission baseline assumes that, as from 2024, changes in the SPB only reflect the impact of ageing costs.
Source: European Commission

For the EU as a whole, at unchanged fiscal policy, the Commission baseline projections point to an initial slight debt reduction until the late 2020s, followed by a renewed increase due to rising ageing costs and a gradually less favourable snowball effect (combining the impact of interest payments and nominal growth on debt dynamics). General government debt is projected to decline until the late 2020s, from around 85% of GDP in 2022 to less than 81% in 2027, supported by a still favourable snowball effect (Graph AI.3). However, debt is projected to increase again as from 2028 due to increasing pressure from ageing costs and to less supportive snowball effects, reflecting the progressive pass-through of higher market interest rates to the implicit

interest rate for governments. The EU aggregate debt ratio is expected to reach about 85% of GDP in 2033, above the pre-COVID-19 level. A similar picture emerges for the euro area as a whole: the debt ratio is projected to decline from 93% of GDP in 2022 to less than 89% in 2027 before rebound slightly thereafter, reaching 94% of GDP in 2033.

Graph AI.4: Medium-term debt projection: Commission baseline based on the Spring forecast 2023



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 2024, changes in the SPB only reflect the impact of ageing costs.
Source: European Commission

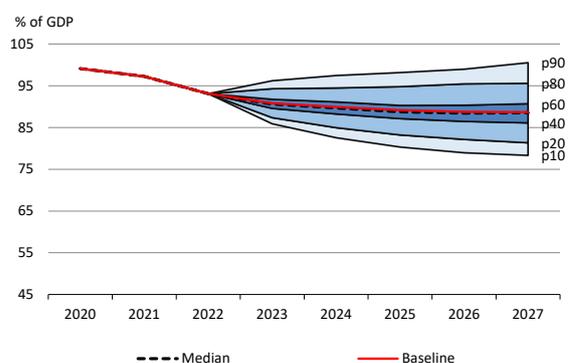
There is heterogeneity across Member States in terms of debt levels, and of timing, magnitude and persistence of projected debt reduction. According to the Commission baseline, the debt-to-GDP ratio projected for 2033 will remain at or below its 2022 level in 13 Member States (Graph AI.4). In most of these countries, debt is expected to start declining by 2024 at the latest, before either broadly stabilising or

declining further over the medium term. In Austria, Germany, Spain, Croatia, Hungary and Finland, however, debt is projected to increase again in the final years of the projection period. In the remaining 14 Member States, at unchanged policies, debt is projected to increase overall between 2022 and 2033, in some cases from a high starting level (e.g. Italy, Belgium and France).

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

The Commission assesses medium-term fiscal sustainability risks based on its comprehensive DSA toolkit, in line with the Debt Sustainability Monitor 2022. In addition to a baseline, the DSA routinely comprises a set of deterministic 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 AI.9 and AI.10.

Graph AI.5: **Stochastic debt projections, 2023-2027, euro area**



Note: for more information on the methodology, see the 2022 Debt Sustainability Monitor

Source: European Commission

The baseline projections are surrounded by a high degree of uncertainty for the euro area as a whole. 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 (30%) probability that debt in the euro area will be higher in 2027 than it was in 2022 (Graph AI.5).⁽⁴⁴⁾ The degree of uncertainty varies greatly across Member States. On the one hand, it indicates very low uncertainty for some countries such as Denmark, where the debt ratio is likely to lie within a narrow range of 12% to 30% of GDP in 2027; moreover, debt in Denmark is projected to decrease with a high probability (90%). At the other end of the spectrum, uncertainty appears to be particularly large for Belgium, Greece, Spain, Croatia, Italy,

Cyprus, Hungary, Portugal and Romania, given historical volatility and/or their high debt level. Moreover, the risk of debt increasing is high in Belgium, Spain, France, Italy, and Slovakia.

The DSA finds that eight Member States face high sustainability risks in the medium term. According to the DSA, the Member States that face high sustainability risks over the medium term are Belgium, Greece, Spain, France, Italy, Hungary, Portugal and Slovakia (see Table AI.1 and AI.3). In most of these countries, the results are driven by high and/or increasing debt ratios by 2033 under the no policy change baseline scenario (Belgium, Greece, France, Italy and Portugal), along with elevated uncertainty surrounding the baseline projections, as highlighted by the stochastic analysis and/or by vulnerability to more adverse assumptions (Spain, Hungary and Slovakia). Moreover, an additional eleven Member States face medium risks according to the DSA, namely Bulgaria, Czechia, Germany, Croatia, Cyprus, Malta, the Netherlands, Poland, Romania, Slovenia, and Finland, with overall consistent signals across the different scenarios considered. The remaining eight Member States are classified at low risk. These are Denmark, Estonia, Ireland, Latvia, Lithuania, Luxembourg, Austria and Sweden.

⁽⁴⁴⁾ The methodology for stochastic debt projections is presented in Annex A7 of the ‘Debt Sustainability Report 2022’, *European Economy, Institutional Paper* 199, April 2023, and in Berti, K. (2013), Stochastic public debt projections using the historical variance-covariance matrix approach for EU countries, *European Economy — Economic Paper*, No.480.

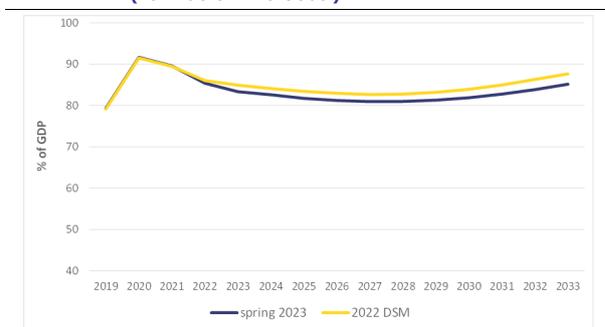
Several additional factors may affect fiscal sustainability risks ⁽⁴⁵⁾

On the upside, some factors contribute to mitigating debt sustainability risks across the EU. One of these is the lengthening of debt maturities in recent years, so that higher market interest rates pass through only slowly to actual interest payments. Other mitigating factors also include relatively stable financing sources, with a diversified and large investor base. Moreover, the implementation of reforms under NGEU/RRF is still expected to have a positive (although diminishing) impact on EU growth, which would support debt sustainability in the coming years.

On the downside, additional risks could emerge. Some are related to the recent increase of interest rates, which could aggravate vulnerabilities in some Member States. In particular, persistently high inflation could make inflation expectations rise further and translate into higher policy interest rates and inflation risk premia, which could increase borrowing costs, especially in highly-indebted Member States. Risk-increasing factors also include the rise in many Member States of the share of short-term debt, which has only partially receded since the COVID-19 crisis, and a possible materialisation of government contingent liabilities stemming from the private sector, including State-guaranteed loans granted during the pandemic. In addition, some non-euro area Member States are also exposed to foreign exchange rate risks.

Despite the uncertain economic outlook, projected debt developments over the medium term have slightly improved on aggregate since autumn 2022, with a broad stability in the DSA risk classification

Graph Al.6: Euro area debt projections: 2023 spring forecast compared with 2022 Debt Sustainability Monitor (2022 autumn forecast)



Source: European Commission

Government debt projections have slightly improved for the EU as a whole, compared with the results from autumn 2022 as published in the 2022 Debt Sustainability Monitor. Compared with the 2022 Debt Sustainability Monitor, which was based on the Commission 2022 autumn forecast, the debt ratio projected in the spring 2023 baseline is about 2.5 pps. of GDP lower for the EU as a whole by 2033. These results mainly reflect the better-than-expected budgetary outturn for 2022 (with lower debt levels and higher SPBs in many countries). However, beyond 2022, this was partially offset by 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 prices) and to support energy diversification.⁽⁴⁶⁾ The further tightening of financing conditions also generally implies a less supportive ‘r-g’ differential.⁽⁴⁷⁾

⁽⁴⁵⁾ The Commission framework considers additional mitigating and aggravating risk factors in the overall assessment, to further qualify the medium-term risk classification.

⁽⁴⁶⁾ By 2023, all temporary emergency measures taken in response to the COVID-19 crisis are expected to be phased out and at unchanged policies, most of the energy-related measures are projected to unwind. The total net budgetary cost of the measures related to energy and support to persons fleeing Ukraine are estimated to amount to around 2.6% of GDP in cumulated terms in 2022-2023. In 2024, the measures related to energy are expected to be mostly phased out, while the measures related to support to persons fleeing Ukraine are set to remain broadly constant (at around 0.1% of GDP).

⁽⁴⁷⁾ By 2033, the nominal implicit interest rate is projected to be higher in the Commission baseline (based on the Commission 2023 spring forecast) than in the 2022 Debt Sustainability Monitor in all Member States but Poland and Romania.

Table AI.3: Detailed medium-term sustainability risk classification based on the Commission spring forecast

		Heat map for medium-term risks in the EU countries - Debt sustainability analysis (DSA)																											
		BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	
Baseline (no-fiscal-policy-change scenario)		HIGH	MEDIUM	MEDIUM	LOW	LOW	LOW	LOW	HIGH	MEDIUM	HIGH	MEDIUM	HIGH	LOW	LOW	LOW	LOW	MEDIUM	LOW	LOW	LOW	MEDIUM	HIGH	MEDIUM	MEDIUM	MEDIUM	LOW	LOW	
Debt level (2033)		125.8	60.6	53.5	7.3	63.5	25.8	20.6	126.1	106.0	125.6	62.9	156.5	40.6	51.6	33.2	33.4	72.5	59.7	61.6	69.2	55.0	91.8	65.2	81.2	84.7	75.6	15.7	
Debt peak year		2033	2033	2033	2023	2022	2033	2022	2022	2022	2033	2022	2033	2022	2033	2022	2033	2022	2033	2022	2033	2033	2022	2033	2033	2033	2033	2024	2022
Fiscal consolidation space (percentile rank of avg SPB 2024-2033)		93%	100%	33%	68%	66%	62%	46%	23%	63%	92%	41%	63%	28%	76%	16%	100%	44%	64%	94%	88%	41%	24%	68%	76%	63%	95%	60%	
Stochastic projections		HIGH	MEDIUM	LOW	LOW	LOW	LOW	MEDIUM	HIGH	HIGH	MEDIUM	HIGH	MEDIUM	LOW	LOW	LOW	MEDIUM	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM	HIGH	MEDIUM	LOW	
Probability of debt in 2027 > debt in 2022		66%	97%	49%	10%	35%	95%	9%	10%	32%	59%	28%	47%	4%	61%	34%	60%	46%	64%	47%	16%	66%	22%	57%	40%	68%	58%	16%	
Difference between the 10th and 90th percentile in 2027 (p.p. of GDP)		37.2	26.2	25.6	17.8	25.2	9.3	28.4	57.7	37.4	21.0	32.6	43.2	37.3	31.7	28.0	24.3	48.4	25.0	24.8	25.8	19.2	54.8	35.0	28.9	31.0	26.6	17.1	
'Historical SPB' scenario		HIGH	LOW	MEDIUM	LOW	LOW	LOW	LOW	HIGH	MEDIUM	HIGH	MEDIUM	HIGH	LOW	LOW	LOW	LOW	HIGH	LOW	LOW	LOW	MEDIUM	HIGH	MEDIUM	MEDIUM	HIGH	LOW	LOW	
Debt level (2033)		110.5	32.9	52.0	9.2	54.0	25.6	41.4	118.2	108.3	122.7	63.4	144.3	47.5	51.0	44.5	19.0	76.4	45.2	53.7	66.8	62.3	101.2	67.9	74.1	76.9	69.3	16.5	
Debt peak year		2033	2028	2033	2023	2022	2033	2022	2022	2022	2033	2022	2022	2022	2033	2033	2024	2033	2025	2033	2022	2033	2022	2033	2033	2033	2033	2024	2022
Fiscal consolidation space (percentile rank of avg SPB 2024-2033)		87%	89%	32%	69%	39%	61%	72%	22%	69%	88%	42%	46%	31%	75%	55%	82%	50%	50%	85%	80%	75%	41%	76%	58%	49%	83%	60%	
'Adverse r-g' scenario		HIGH	MEDIUM	MEDIUM	LOW	MEDIUM	LOW	LOW	HIGH	HIGH	HIGH	MEDIUM	HIGH	LOW	LOW	LOW	LOW	HIGH	MEDIUM	MEDIUM	LOW	MEDIUM	HIGH	MEDIUM	MEDIUM	MEDIUM	MEDIUM	LOW	
Debt level (2033)		135.1	64.1	57.5	8.8	68.9	27.6	22.6	136.3	115.0	135.5	68.1	169.9	45.1	55.2	35.8	35.7	79.2	64.0	66.1	74.9	59.4	100.0	69.9	87.1	89.6	81.4	17.5	
Debt peak year		2033	2033	2033	2023	2033	2033	2022	2022	2033	2033	2022	2033	2022	2033	2022	2033	2022	2033	2033	2033	2022	2033	2022	2033	2033	2033	2033	2022
Fiscal consolidation space (percentile rank of avg SPB 2024-2033)		93%	100%	33%	68%	66%	62%	46%	23%	63%	92%	41%	63%	28%	76%	16%	100%	44%	64%	94%	88%	41%	24%	68%	76%	63%	95%	60%	
'Financial stress' scenario		HIGH	MEDIUM	MEDIUM	LOW	LOW	LOW	LOW	HIGH	MEDIUM	HIGH	MEDIUM	HIGH	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	LOW	MEDIUM	HIGH	MEDIUM	MEDIUM	MEDIUM	LOW	LOW	
Debt level (2033)		127.3	60.8	53.9	7.5	64.0	26.0	20.7	135.0	108.0	127.5	63.3	161.3	40.9	51.9	33.4	33.6	73.2	60.1	62.0	69.8	55.3	93.6	65.7	81.8	84.9	76.1	15.8	
Debt peak year		2033	2033	2033	2023	2022	2033	2022	2022	2022	2033	2022	2033	2022	2033	2022	2033	2022	2033	2022	2033	2022	2033	2022	2033	2033	2033	2024	2022
Fiscal consolidation space (percentile rank of avg SPB 2024-2033)		93%	100%	33%	68%	66%	62%	46%	23%	63%	92%	41%	63%	28%	76%	16%	100%	44%	64%	94%	88%	41%	24%	68%	76%	63%	95%	60%	
'Lower SPB' scenario		HIGH	MEDIUM	MEDIUM	LOW	MEDIUM	LOW	LOW	HIGH	MEDIUM	HIGH	MEDIUM	HIGH	LOW	MEDIUM	LOW	LOW	HIGH	MEDIUM	MEDIUM	MEDIUM	MEDIUM	HIGH	MEDIUM	MEDIUM	HIGH	MEDIUM	LOW	
Debt level (2033)		125.9	67.8	58.4	13.1	70.2	28.5	28.3	137.2	110.1	128.9	68.0	178.0	42.7	61.4	34.2	37.7	96.7	68.9	64.9	81.8	66.2	95.7	77.7	88.2	93.7	77.6	15.2	
Debt peak year		2033	2033	2033	2023	2033	2033	2022	2022	2022	2033	2022	2033	2022	2033	2022	2033	2022	2033	2033	2033	2033	2022	2033	2033	2033	2033	2022	
Fiscal consolidation space (percentile rank of avg SPB 2024-2033)		93%	100%	36%	74%	78%	77%	61%	38%	73%	93%	46%	74%	29%	79%	20%	100%	69%	82%	96%	96%	85%	33%	81%	83%	79%	97%	64%	

Note: For more information on the methodology, see the 2022 Debt Sustainability Monitor

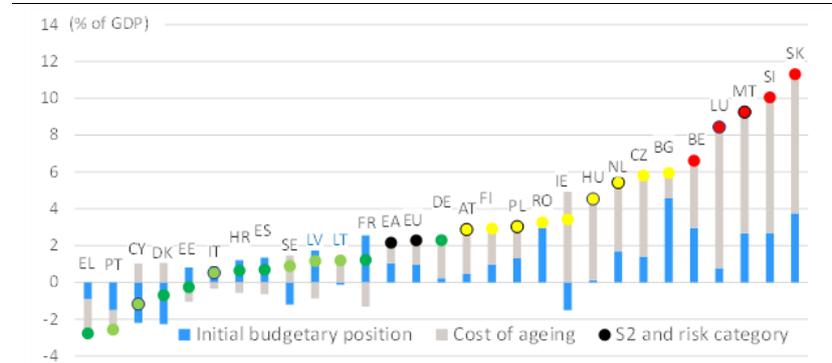
Source: European Commission

The DSA risk classification remained unchanged for most Member States, with changes only in three countries (Bulgaria, Croatia and Austria). Bulgaria has deteriorated its risk classification by moving from the low-risk to medium-risk category, given a (newly announced) increase in wages and pensions, and the uncertainty related to potential consolidation measures (under the ‘no-fiscal policy change’ assumption). Croatia has improved its risk classification by moving from the high-risk to medium-risk category, given a better initial fiscal position (in terms of SPB and government debt), notably reflecting better outturn data, as well as new (improved) population projections by Eurostat (EUROPOP 2023). Austria has also improved its risk classification by moving from the medium-risk to low-risk category, reflecting a better starting position, due in large part to (better) energy price developments, with the country being a borderline low-/medium-risk case at the time of the Commission 2022 autumn forecast.

AI.4. LONG-TERM RISKS

In line with the Debt Sustainability Monitor 2022, the Commission’s long-term risk classification is based on two complementary fiscal gap indicators (S2 and S1) that show the fiscal effort required to achieve two specific long-term fiscal goals.⁽⁴⁸⁾ The *S2 indicator* measures the fiscal effort (i.e., 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 *S1 indicator* measures the fiscal effort required to bring the government debt-to-GDP ratio to 60% in 2070, hence capturing vulnerabilities due to high debt levels (through a third component: the debt requirement).

Graph AI.7: 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 2022 Debt Sustainability Monitor.

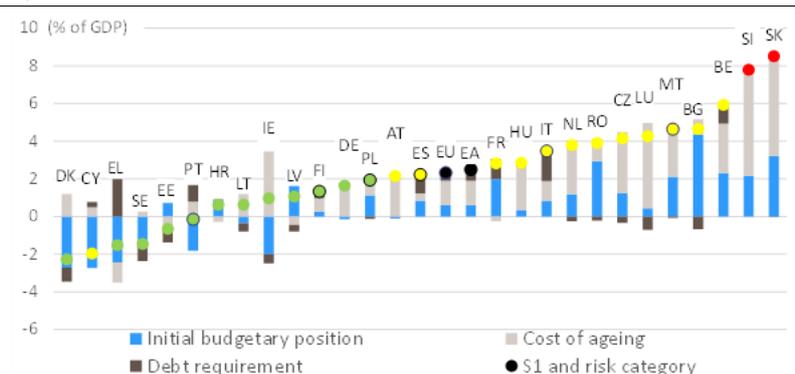
Source: European Commission

Age-related costs are projected to weigh on the long-term sustainability of public finances in a majority of Member States, with the S2 indicator signalling high or medium sustainability risks in 15 Member States over the long term (Graph AI.7). For a majority of those countries, the risks are mainly attributable to the projected increase in the cost of ageing. The latter is due to the significant projected increase in pension spending (largest component in Luxembourg, Malta, Slovenia and Slovakia), as well as in healthcare and/or long-term care spending (largest component in Malta and

⁽⁴⁸⁾ The methodological approach differs from the 2021 Fiscal Sustainability Report, which determined long-term fiscal risks based on the S2 indicator and the DSA results. See further detail in European Commission (2023), 'Debt Sustainability Report 2022', *European Economy, Institutional Paper* 199, April 2023, https://economy-finance.ec.europa.eu/publications/debt-sustainability-monitor-2022_en.

Slovakia). In most Member States except Greece, Portugal, Cyprus, Denmark and Estonia, a fiscal adjustment is required based on at least one of the two S2 indicators' components. However, in some of these cases, these favourable results are conditional on the countries maintaining the positive structural primary balance expected in 2024, and swiftly implementing past pension reforms.

Graph AI.8: Breakdown of the S1 indicator, Commission baseline



Notes: (1) This graph breaks down the S1 indicator into the initial budgetary position, debt requirement and the long-term budgetary impact of population ageing ('cost of ageing'). The S1 indicator measures the fiscal effort required to bring the government debt-to-GDP ratio to 60% in 2070. (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 2022 Debt Sustainability Monitor.

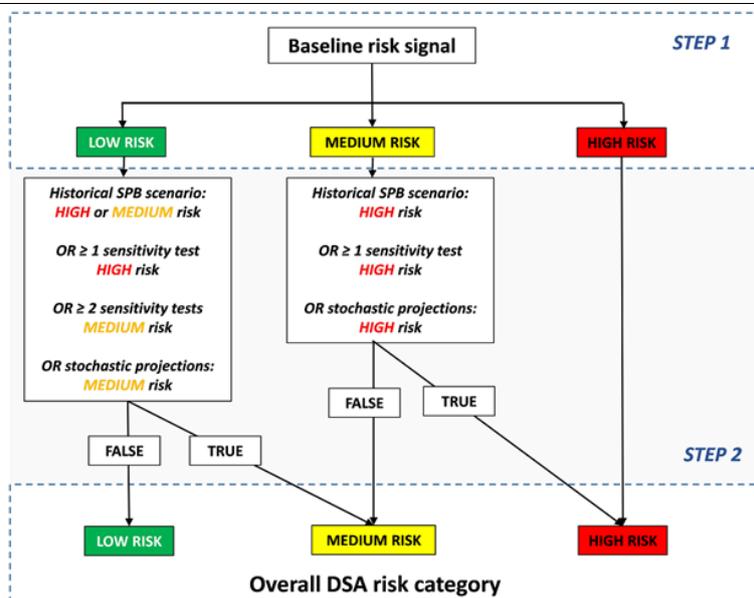
Source: European Commission

The S1 indicator identifies debt vulnerabilities over the long-term. According to the S1 indicator, two Member States (Slovakia and Slovenia) are identified as having high fiscal risks, twelve Members States as having medium risks and thirteen Members States as having low risks in the long term. As for the S2 indicator, in seventeen Member States, ageing costs are the main determinant for the S1 indicator. In twenty Member States, unfavourable initial budgetary positions also increase the S1 indicator, as well as in fourteen Member States for the debt requirement.

Combining the S2 and S1 results, overall long-term fiscal sustainability risks are considered to be high in five Member States (Belgium, Luxembourg, Malta, Slovenia and Slovakia). The driving factor behind the high-risk assessment is the S2 indicator and largely reflects increasing ageing costs. Thirteen Member States face medium fiscal sustainability risks in the long term (Bulgaria, Czechia, Germany, Ireland, Spain, France, Italy, Hungary, the Netherlands, Austria, Poland, Romania and Finland). This is mainly due to the S2 indicator. Only in Spain, France and Italy is the overall risk classification modified by the S1 indicator, which causes a deterioration of the overall risk classification from low to medium risk over the long term, given debt vulnerabilities captured by the S1 indicator. Nine Member States face low fiscal sustainability risks in the long term (Denmark, Estonia, Greece, Croatia, Cyprus, Latvia, Lithuania, Portugal and Sweden).

Compared to the 2022 Debt Sustainability Monitor, the long-term risk classification has remained broadly unchanged, with revisions for only two countries. This concerns Croatia and Hungary, with an improvement of the classification: from high to medium risk for Hungary, thanks to the S2 indicator now pointing to medium risk on the back of a more favourable initial budgetary position; while for Croatia, the classification has moved from medium risk to low risk thanks to both the S2 and the S1 indicators now pointing to low risk, on the back of a more favourable initial budgetary position.

Graph Al.9: Risk classification derived from the debt sustainability analysis: decision tree



Source: European Commission

Graph Al.10: Risk classification derived from the debt sustainability analysis: assessment criteria and thresholds

Case	Deterministic projections				Stochastic projections		
	Debt level	Debt path	Consolidation space	Overall	Probability of debt not stabilising	Size of uncertainty	Overall
1	HIGH	HIGH/MEDIUM	ANY	HIGH	HIGH	ANY	HIGH
2	HIGH	LOW	HIGH/MEDIUM	HIGH	HIGH	ANY	HIGH
3	HIGH	LOW	LOW	MEDIUM	MEDIUM	HIGH	MEDIUM
4	MEDIUM	HIGH	HIGH/MEDIUM	HIGH	MEDIUM	MEDIUM	MEDIUM
5	MEDIUM	HIGH	LOW	MEDIUM	MEDIUM	LOW	LOW
6	MEDIUM	MEDIUM	ANY	MEDIUM	LOW	HIGH	MEDIUM
7	MEDIUM	LOW	HIGH/MEDIUM	MEDIUM	LOW	MEDIUM	LOW
8	MEDIUM	LOW	LOW	LOW	LOW	LOW	LOW
9	LOW	HIGH	HIGH/MEDIUM	MEDIUM			
10	LOW	HIGH	LOW	LOW			
11	LOW	MEDIUM/LOW	ANY	LOW			

	Criterion	Threshold
Deterministic projections	Debt level in 2033	High: above 90% of GDP Medium: between 60% and 90% of GDP Low: below 60% of GDP
	Debt trajectory (debt peak year)	High: peak year between T+7 (2029) and end of projections (2033), or still increasing by end of projections Medium: peak year between T+3 (2025) and T+6 (2028) Low: peak year within the T+2 forecast horizon (2022-2024)
	Fiscal consolidation space (percentile rank of average SPB in 2024-2033)	High: up to 25% Medium: between 25% and 50% Low: above 50%
Stochastic projections	Probability of debt not stabilising over the next 5 years, i.e. of debt ratio in 2027 exceeding the initial debt ratio	Initial debt ratio ≥ 90% 60% ≤ initial debt ratio < 90% Initial debt ratio < 60%
	Size of macroeconomic uncertainty (diff. btw 10 th and 90 th percentiles of the distribution of debt paths)	High: if probability > 30% Medium: if 0 < probability ≤ 30% Low: if probability = 0
		High: if probability > 60% Medium: if 30% < probability ≤ 60% Low: if probability ≤ 30%
	High: if probability > 70% Low: if probability ≤ 70%	

Source: European Commission

ANNEX II

Key macro-fiscal indicators

Table All.1: Real GDP growth (%)

	2023 Spring forecast			2023 Stability and Convergence Programmes				Difference SCPs vs SF2023	
	2022	2023	2024	2023	2024	2025	2026	2023	2024
BE	3.2	1.2	1.4	1.0	1.7	1.3	1.4	-0.2	0.3
CY	5.6	2.3	2.7	2.8	3.0	3.1	3.2	0.5	0.3
DE	1.8	0.2	1.4	0.2	1.8	0.9	0.9	0.0	0.4
EE	-1.3	-0.4	3.1	-1.5	3.0	2.5	2.3	-1.1	-0.1
EL	5.9	2.4	1.9	2.3	3.0	3.0	2.1	-0.1	1.1
IE	12.0	5.5	5.0	5.6	4.1	4.9	4.4	0.1	-0.9
ES	5.5	1.9	2.0	2.1	2.4	1.8	1.7	0.2	0.4
FR	2.6	0.7	1.4	1.0	1.6	1.7	1.7	0.3	0.2
HR	6.2	1.6	2.3	2.2	2.6	2.5	2.2	0.7	0.4
IT	3.7	1.2	1.1	1.0	1.5	1.3	1.1	-0.2	0.4
LV	2.8	1.4	2.8	0.0	2.0	2.9	2.8	-1.4	-0.8
LT	1.9	0.5	2.7	0.5	3.0	3.0	3.0	0.0	0.3
LU	1.5	1.6	2.4	2.4	3.8	2.9	2.5	0.8	1.4
MT	6.9	3.9	4.1	4.1	4.5	4.6	4.2	0.2	0.4
NL	4.5	1.8	1.2	1.6	1.4	1.1	1.1	-0.2	0.2
AT	5.0	0.4	1.6	0.3	1.8	2.1	2.0	-0.1	0.2
PT	6.7	2.4	1.8	1.8	2.0	2.0	1.9	-0.7	0.3
SI	5.4	1.2	2.2	1.8	2.5	2.6	2.5	0.6	0.3
SK	1.7	1.7	2.1	1.3	1.8	2.7	1.9	-0.5	-0.4
FI	2.1	0.2	1.4	-0.2	1.3	1.6	1.6	-0.4	-0.1
BG	3.4	1.5	2.4	1.8	3.3	3.2	3.0	0.3	0.9
CZ	2.5	0.2	2.6	0.1	3.0	2.9	2.5	-0.1	0.3
DK	3.8	0.3	1.5	0.6	1.4	1.1	0.5	0.3	-0.1
HU	4.6	0.5	2.8	1.5	4.0	4.3	4.5	1.0	1.2
RO	4.7	3.2	3.5	2.8	4.8	5.0	4.6	-0.4	1.3
PL	5.1	0.7	2.7	0.9	2.8	3.2	3.0	0.2	0.1
SE	2.6	-0.5	1.1	-1.0	1.2	2.6	3.2	-0.5	0.1
EA	3.5	1.1	1.6	1.1	1.9	1.6	1.5	0.0	0.3
EU	3.6	1.0	1.7	1.0	2.0	1.8	1.7	0.0	0.3

Source: European Commission 2023 spring forecast and 2023 SCPs

Table All.2: GDP deflator growth (%)

	2023 Spring forecast			2023 Stability and Convergence Programmes				Difference SCPs vs SF2023	
	2022	2023	2024	2023	2024	2025	2026	2023	2024
BE	5.9	3.8	2.3	3.4	2.3	1.9	1.7	-0.4	0.0
CY	6.4	5.0	2.8	3.8	2.4	2.1	2.1	-1.2	-0.4
DE	5.5	6.1	2.4	5.9	2.7	2.0	2.0	-0.2	0.3
EE	16.6	10.3	3.6	7.6	2.6	2.1	1.9	-2.7	-1.0
EL	8.1	4.7	2.9	4.1	1.8	2.0	2.0	-0.6	-1.1
IE	5.3	4.6	2.5	4.0	2.3	2.2	2.2	-0.6	-0.2
ES	4.3	4.4	2.9	4.0	3.5	2.1	1.9	-0.4	0.6
FR	3.0	5.4	2.6	5.4	2.7	1.8	1.6	0.0	0.1
HR	8.2	7.5	3.2	7.9	3.7	2.7	2.4	0.3	0.5
IT	3.0	5.9	2.7	4.8	2.7	2.0	2.0	-1.1	0.0
LV	13.1	8.9	2.7	11.7	3.4	2.7	2.7	2.8	0.7
LT	16.8	10.4	3.1	9.8	2.3	2.0	2.0	-0.6	-0.8
LU	6.4	5.5	3.4	2.2	2.1	2.5	2.1	-3.3	-1.3
MT	5.2	4.2	3.1	4.3	3.0	2.5	2.6	0.1	-0.1
NL	5.3	6.1	2.6	6.2	3.0	2.8	2.7	0.1	0.4
AT	5.0	7.2	4.2	7.1	4.2	3.1	2.6	-0.1	0.0
PT	4.4	5.8	2.3	5.7	3.0	2.4	2.3	-0.1	0.7
SI	7.2	7.3	4.3	7.7	3.9	2.5	2.2	0.4	-0.5
SK	7.5	9.8	5.7	7.8	5.5	4.1	2.5	-2.1	-0.2
FI	4.2	4.4	2.4	4.1	2.2	2.3	2.2	-0.3	-0.2
BG	15.1	10.4	3.9	9.5	3.7	3.1	2.8	-0.9	-0.2
CZ	8.6	11.3	5.5	9.9	3.8	2.8	2.2	-1.4	-1.7
DK	7.6	0.2	2.1	-1.9	2.5	1.9	2.5	-2.1	0.4
HU	15.3	13.0	3.5	14.8	5.6	4.2	4.0	1.8	2.1
RO	13.4	10.7	5.8	9.7	5.4	3.6	3.3	-1.0	-0.4
PL	11.3	11.8	5.8	10.9	6.4	3.8	3.0	-0.9	0.6
SE	5.7	5.7	1.6	5.1	2.0	1.9	2.1	-0.6	0.4
EA	4.6	5.7	2.7	5.3	2.8	2.1	2.0	-0.3	0.2
EU	5.4	6.1	2.9	5.7	3.1	2.3	2.1	-0.4	0.2

Source: European Commission 2023 spring forecast and 2023 SCPs

Table All.3: HICP inflation (%)

	2023 Spring forecast			2023 Stability and Convergence Programmes				Difference SCPs vs SF2023	
	2022	2023	2024	2023	2024	2025	2026	2023	2024
BE	10.3	3.4	3.5	4.5	2.9	1.8	1.7	1.1	-0.6
CY	8.1	3.8	2.5	3.2	2.5	2.0	2.0	-0.6	0.0
DE	8.7	6.8	2.7	5.5	2.2	2.0	2.0	-1.3	-0.5
EE	19.4	9.2	2.8	9.3	3.1	2.2	1.4	0.1	0.3
EL	9.3	4.2	2.4	4.5	2.4	2.0	2.0	0.3	0.0
IE	8.1	4.6	2.6	4.9	2.5	2.0	2.0	0.3	-0.1
ES	8.3	4.0	2.7	3.9	3.2	2.0	1.9	-0.1	0.5
FR	5.9	5.5	2.5	5.7	2.7	2.1	1.9	0.2	0.2
HR	10.7	6.9	2.2	6.6	2.8	2.4	2.2	-0.2	0.6
IT	8.7	6.1	2.9	5.9	2.8	2.1	2.0	-0.2	-0.1
LV	17.2	9.3	1.7	10.0	2.2	2.5	2.5	0.7	0.5
LT	18.9	9.2	2.2	8.5	2.3	2.0	2.0	-0.7	0.1
LU	8.2	3.2	2.6	3.2	2.7	2.7	1.5	0.0	0.1
MT	6.1	5.4	2.8	5.7	3.5	2.0	2.4	0.3	0.7
NL	11.6	4.9	3.3	2.9	3.2	2.2	2.2	-2.0	-0.1
AT	8.6	7.1	3.8	7.1	3.8	3.0	2.5	0.0	0.0
PT	8.1	5.1	2.7	5.1	2.9	2.1	2.0	0.1	0.2
SI	9.3	7.0	3.8	7.1	4.2	2.4	2.0	0.1	0.4
SK	12.1	10.9	5.7	9.7	5.5	4.3	2.2	-1.2	-0.2
FI	7.2	4.8	2.1	4.0	1.9	2.0	2.0	-0.8	-0.2
BG	13.0	9.4	4.2	8.7	3.8	2.8	2.2	-0.7	-0.4
CZ	14.8	11.9	3.4	12.2	2.6	2.2	2.0	0.3	-0.7
DK	8.5	4.3	2.5	4.3	3.0	2.2	2.0	0.0	0.5
HU	15.3	16.4	4.0	15.0	6.0	3.0	3.0	-1.4	2.0
RO	12.0	9.7	4.6	10.7	5.4	3.2	2.9	1.0	0.8
PL	13.2	11.7	6.0	11.6	6.5	3.9	3.1	-0.1	0.5
SE	8.1	6.0	1.9	5.9	2.1	1.9	1.9	-0.1	0.2
EA	8.4	5.8	2.8	5.3	2.7	2.1	2.0	-0.5	-0.1
EU	9.2	6.7	3.1	5.9	3.0	2.2	2.1	-0.8	-0.2

Source: European Commission 2023 spring forecast and 2023 SCPs

Table All.4: Budget balance (% of GDP)

	2023 Spring forecast			2023 Stability and Convergence Programmes				Difference SCPs vs SF2023	
	2022	2023	2024	2023	2024	2025	2026	2023	2024
BE	-3.9	-5.0	-4.7	-5.1	-4.2	-3.3	-2.9	-0.1	0.5
CY	2.1	1.8	2.1	2.0	2.3	2.3	2.4	0.1	0.3
DE	-2.6	-2.3	-1.2	-4.1	-1.7	-0.8	-0.7	-1.8	-0.5
EE	-0.9	-3.1	-2.7	-4.3	-4.2	-4.0	-4.5	-1.2	-1.5
EL	-2.3	-1.3	-0.6	-1.8	-0.8	-0.5	-0.1	-0.5	-0.2
IE	1.6	1.7	2.2	1.8	2.8	2.9	3.1	0.1	0.5
ES	-4.8	-4.1	-3.3	-3.9	-3.0	-2.7	-2.5	0.2	0.3
FR	-4.7	-4.7	-4.3	-4.9	-4.4	-3.7	-3.2	-0.2	-0.1
HR	0.4	-0.5	-1.3	-0.7	-1.5	-0.8	-0.6	-0.2	-0.2
IT	-8.0	-4.5	-3.7	-4.4	-3.5	-3.0	-2.5	0.1	0.2
LV	-4.4	-3.8	-2.7	-4.0	-2.5	-2.2	-0.7	-0.2	0.2
LT	-0.6	-1.7	-1.4	-2.2	-1.7	-1.4	-0.9	-0.5	-0.3
LU	0.2	-1.7	-1.5	-1.5	-1.7	-1.0	-0.8	0.2	-0.2
MT	-5.8	-5.1	-4.5	-5.0	-4.3	-3.6	-2.9	0.1	0.2
NL	0.0	-2.1	-1.7	-3.0	-2.6	-2.6	-2.8	-1.0	-0.9
AT	-3.2	-2.4	-1.3	-3.2	-1.6	-1.4	-1.3	-0.8	-0.3
PT	-0.4	-0.1	-0.1	-0.4	-0.2	-0.1	0.0	-0.2	0.0
SI	-3.0	-3.7	-2.9	-4.1	-2.8	-2.2	-1.3	-0.4	0.1
SK	-2.0	-6.1	-4.8	-6.3	-4.7	-5.2	-4.9	-0.2	0.1
FI	-0.9	-2.6	-2.6	-2.6	-2.6	-3.1	-2.9	0.0	0.0
BG	-2.8	-4.8	-4.8	-6.1	-4.7	-4.9	-5.0	-1.3	0.1
CZ	-3.6	-3.6	-3.0	-3.5	-2.9	-2.4	-2.2	0.1	0.0
DK	3.3	2.3	1.3	1.9	0.6	0.4	-0.2	-0.4	-0.7
HU	-6.2	-4.0	-4.4	-3.9	-2.9	-1.9	-1.4	0.1	1.5
RO	-6.2	-4.7	-4.4	-4.4	-3.0	-2.9	-2.9	0.3	1.4
PL	-3.7	-5.0	-3.7	-4.7	-3.4	-2.9	-2.9	0.3	0.3
SE	0.7	-0.9	-0.5	-0.4	-0.6	0.2	1.4	0.5	-0.1
EA	-3.6	-3.2	-2.4	-3.8	-2.6	-2.1	-1.8	-0.7	-0.1
EU	-3.4	-3.1	-2.4	-3.6	-2.5	-2.0	-1.7	-0.5	-0.1

Source: Commission 2023 spring forecast

Table All.5: Primary balance (% of GDP)

	2023 Spring forecast			2023 Stability and Convergence Programmes				Difference SCPs vs SF2023	
	2022	2023	2024	2023	2024	2025	2026	2023	2024
BE	-2.4	-3.3	-2.8	-3.3	-2.2	-1.2	-0.5	-0.1	0.5
CY	3.6	3.2	3.4	3.2	3.7	3.7	3.7	0.1	0.3
DE	-1.9	-1.5	-0.3	-3.4	-0.7	0.2	0.5	-1.9	-0.4
EE	-0.8	-2.7	-2.1	-3.9	-3.6	-3.3	-3.6	-1.2	-1.5
EL	0.1	1.9	2.5	1.1	2.1	2.3	2.5	-0.8	-0.4
IE	2.2	2.3	2.8	2.4	3.3	3.4	3.6	0.2	0.5
ES	-2.4	-1.6	-0.9	-1.5	-0.4	0.1	0.4	0.1	0.5
FR	-2.8	-2.7	-2.3	-3.2	-2.5	-1.6	-0.9	-0.5	-0.2
HR	1.8	0.7	-0.2	0.6	-0.3	0.5	0.7	-0.1	-0.1
IT	-3.6	-0.5	0.5	-0.6	0.5	1.2	2.0	-0.1	0.0
LV	-3.9	-3.2	-1.9	-3.4	-1.7	-1.2	0.4	-0.2	0.2
LT	-0.3	-1.3	-0.7	-1.8	-1.1	-0.5	0.0	-0.5	-0.4
LU	0.3	-1.5	-1.1	-1.3	-1.5	-0.7	-0.4	0.2	-0.4
MT	-4.8	-3.9	-3.1	-3.8	-2.8	-2.1	-1.5	0.1	0.2
NL	0.6	-1.4	-1.0	-2.4	-1.9	-1.9	-1.9	-1.0	-1.0
AT	-2.2	-1.3	-0.1	-2.0	-0.2	0.1	0.4	-0.7	-0.1
PT	1.6	2.0	2.6	1.9	2.6	2.7	2.8	-0.1	-0.1
SI	-1.9	-2.5	-1.6	-2.9	-1.5	-0.8	0.0	-0.4	0.1
SK	-1.0	-5.0	-3.6	-5.3	-3.5	-3.8	-3.4	-0.3	0.1
FI	-0.3	-1.7	-1.3	-1.7	-1.3	-1.8	-1.5	0.0	0.0
BG	-2.3	-4.3	-4.2	-5.5	-3.6	-3.7	-3.4	-1.2	0.6
CZ	-2.5	-2.3	-1.6	-2.3	-1.7	-1.2	-0.8	0.0	0.0
DK	4.1	2.9	1.8	2.4	1.1	0.9	0.3	-0.5	-0.7
HU	-3.5	-0.1	-0.1	-0.1	1.2	1.8	2.0	0.0	1.3
RO	-5.0	-2.9	-2.7	-2.7	-1.3	-1.3	-1.3	0.2	1.4
PL	-2.2	-3.0	-1.7	-2.6	-1.2	-0.8	-0.7	0.4	0.5
SE	1.2	-0.2	0.1	0.1	-0.1	0.8	2.0	0.3	-0.2
EA	-1.9	-1.4	-0.6	-2.2	-0.8	-0.1	0.3	-0.8	-0.2
EU	-1.8	-1.4	-0.7	-2.0	-0.8	-0.1	0.3	-0.6	-0.1

Source: European Commission 2023 spring forecast and 2023 SCPs

Table All.6: Public debt (% of GDP)

	2023 Spring forecast			2023 Stability and Convergence Programmes				Difference SCPs vs SF2023	
	2022	2023	2024	2023	2024	2025	2026	2023	2024
BE	105.1	106.0	107.3	106.7	107.1	107.6	107.8	0.7	-0.2
CY	86.5	80.4	72.5	81.1	72.9	67.3	60.1	0.7	0.4
DE	66.3	65.2	64.1	67.7	66.5	66.1	65.4	2.4	2.5
EE	18.4	19.5	21.3	20.2	23.6	27.1	30.4	0.7	2.3
EL	171.3	160.2	154.4	162.6	150.8	142.6	135.2	2.4	-3.6
IE	44.7	40.4	38.3	40.5	38.2	35.0	32.0	0.1	-0.1
ES	113.2	110.6	109.1	111.9	109.1	107.9	106.8	1.3	0.0
FR	111.6	109.6	109.5	109.6	109.5	109.4	109.2	0.0	0.0
HR	68.4	63.0	61.8	62.6	59.8	57.5	55.6	-0.4	-2.0
IT	144.4	140.4	140.3	142.1	141.4	140.9	140.4	1.7	1.1
LV	40.8	39.7	40.5	39.6	39.7	39.8	38.9	-0.2	-0.8
LT	38.4	37.1	36.6	37.8	37.7	39.2	38.6	0.7	1.1
LU	24.6	25.9	27.0	26.1	27.5	28.2	28.6	0.2	0.5
MT	53.4	54.8	56.1	54.5	55.7	56.2	56.1	-0.3	-0.3
NL	51.0	49.3	48.8	48.4	48.7	49.8	51.0	-0.9	-0.1
AT	78.4	75.4	72.7	77.0	75.1	73.3	71.4	1.6	2.4
PT	113.9	106.2	103.1	107.5	103.0	99.2	95.6	1.3	-0.1
SI	69.9	69.1	66.6	68.9	66.5	65.0	63.5	-0.2	-0.1
SK	57.8	58.3	58.7	58.7	59.3	59.8	63.1	0.4	0.6
FI	73.0	73.9	76.2	74.4	76.9	79.0	80.7	0.5	0.7
BG	22.9	25.0	28.1	26.6	30.7	33.8	37.1	1.6	2.6
CZ	44.1	42.9	43.1	43.5	44.0	44.4	45.0	0.6	0.9
DK	30.1	30.1	28.8	30.9	29.7	30.6	31.7	0.8	0.9
HU	73.3	70.7	71.1	69.7	66.7	63.9	59.8	-1.0	-4.4
RO	47.3	45.6	46.1	47.1	46.1	45.8	45.4	1.5	0.0
PL	49.1	50.5	53.0	50.5	52.4	53.6	55.4	0.0	-0.6
SE	33.0	31.4	30.7	31.0	31.0	29.8	27.7	-0.4	0.3
EA	93.1	90.8	89.9	91.9	90.8	90.1	89.4	1.1	0.9
EU	85.4	83.4	82.6	84.3	83.3	82.7	81.9	1.0	0.7

Source: European Commission 2023 spring forecast and 2023 SCPs

Table All.7: Interest expenditure (% of GDP)

	2023 Spring forecast			2023 Stability and Convergence Programmes				Difference SCPs vs SF2023	
	2022	2023	2024	2023	2024	2025	2026	2023	2024
BE	1.5	1.7	2.0	1.7	2.0	2.2	2.4	0.0	0.0
CY	1.5	1.3	1.3	1.3	1.3	1.4	1.3	-0.1	0.0
DE	0.7	0.8	0.9	0.7	0.9	1.1	1.2	-0.1	0.0
EE	0.1	0.4	0.6	0.5	0.6	0.7	0.9	0.1	0.0
EL	2.4	3.2	3.2	3.0	2.9	2.8	2.6	-0.2	-0.3
IE	0.7	0.6	0.6	0.6	0.6	0.5	0.5	0.0	0.0
ES	2.4	2.5	2.4	2.4	2.6	2.7	2.9	-0.1	0.2
FR	1.9	2.0	2.0	1.7	1.9	2.1	2.3	-0.3	-0.1
HR	1.4	1.2	1.2	1.3	1.3	1.2	1.3	0.1	0.1
IT	4.4	4.0	4.1	3.7	4.1	4.2	4.5	-0.3	0.0
LV	0.5	0.6	0.8	0.6	0.8	1.0	1.1	0.0	0.0
LT	0.4	0.5	0.6	0.5	0.6	0.8	0.9	0.0	0.0
LU	0.2	0.3	0.3	0.2	0.2	0.3	0.4	-0.1	-0.1
MT	1.0	1.2	1.5	1.2	1.5	1.5	1.4	0.0	0.0
NL	0.5	0.7	0.7	0.6	0.7	0.7	0.8	-0.1	-0.1
AT	0.9	1.1	1.3	1.2	1.4	1.5	1.6	0.1	0.1
PT	2.0	2.2	2.7	2.3	2.7	2.8	2.8	0.1	0.0
SI	1.1	1.2	1.3	1.2	1.3	1.3	1.3	0.0	0.0
SK	1.0	1.1	1.2	1.0	1.2	1.4	1.5	-0.1	0.0
FI	0.5	0.8	1.2	0.8	1.3	1.3	1.4	0.0	0.1
BG	0.5	0.5	0.6	0.6	1.0	1.3	1.7	0.1	0.4
CZ	1.2	1.3	1.3	1.2	1.3	1.3	1.4	-0.1	0.0
DK	0.7	0.6	0.5	0.5	0.5	0.5	0.5	-0.1	0.0
HU	2.8	3.9	4.3	3.8	4.1	3.7	3.4	-0.1	-0.2
RO	1.2	1.8	1.7	1.7	1.7	1.6	1.6	-0.1	0.0
PL	1.6	2.0	2.1	2.1	2.2	2.1	2.2	0.1	0.1
SE	0.5	0.7	0.6	0.5	0.6	0.6	0.6	-0.2	0.0
EA	1.7	1.7	1.8	1.6	1.8	2.0	2.1	-0.1	0.0
EU	1.6	1.7	1.8	1.6	1.8	1.9	2.0	-0.1	0.0

Source: European Commission 2023 spring forecast and 2023 SCPs

Table All.8: Energy support measures (level; % of GDP)

	1. Targeted		2. Untargeted		3. Windfall revenues from energy sector		Net budgetary impact (1+2-3)	
	2022	2023	2022	2023	2022	2023	2022	2023
AT	0.2	0.4	1.3	1.7	0.0	0.3	1.5	1.8
BE	0.2	0.1	0.7	0.5	0.1	0.2	0.9	0.4
BG	0.0	0.0	3.4	1.0	1.9	0.2	1.5	0.8
CY	0.1	0.0	0.5	0.4	0.0	0.0	0.7	0.4
CZ	0.2	0.1	0.5	1.7	0.0	0.5	0.7	1.3
DE	0.3	0.5	0.9	1.5	0.0	0.0	1.2	2.0
DK	0.1	0.1	0.0	0.1	0.0	0.0	0.1	0.3
EE	0.1	0.0	0.7	0.3	0.0	0.0	0.8	0.3
EL	0.5	0.1	4.3	0.8	2.3	0.7	2.5	0.2
ES	0.5	0.2	1.1	0.5	0.0	0.1	1.6	0.6
FI	0.0	0.1	0.1	0.3	0.0	0.1	0.1	0.3
FR	0.1	0.2	1.3	1.3	0.4	0.5	0.9	1.0
HR	0.3	0.2	1.2	1.3	0.0	0.0	1.6	1.5
HU	0.1	0.0	1.3	2.0	0.3	0.9	1.0	1.2
IE	0.2	0.1	0.3	0.3	0.0	0.0	0.5	0.3
IT	1.3	0.7	1.6	0.5	0.3	0.2	2.5	1.0
LT	0.0	0.0	1.3	0.7	0.0	0.0	1.3	0.7
LU	0.4	0.6	0.1	0.5	0.0	0.0	0.5	1.1
LV	0.5	0.1	0.9	0.8	0.0	0.0	1.5	1.0
MT	0.1	0.1	2.4	1.6	0.0	0.0	2.5	1.7
NL	0.1	0.5	0.9	0.6	0.4	0.0	0.6	1.1
PL	0.1	0.2	1.8	2.4	0.0	0.9	1.9	1.7
PT	1.0	0.3	1.0	0.5	0.0	0.0	2.0	0.8
RO	0.8	0.6	0.7	0.3	1.1	0.6	0.4	0.3
SE	0.0	0.0	0.2	0.7	0.0	0.6	0.2	0.1
SI	0.6	0.1	0.5	0.8	0.0	0.0	1.0	0.9
SK	0.2	0.0	0.3	2.4	0.4	0.4	0.2	2.0
EA	0.4	0.4	1.1	1.0	0.2	0.2	1.3	1.2
EU	0.4	0.3	1.1	1.0	0.2	0.2	1.2	1.1

Source: European Commission 2023 spring forecast

Table All.9: **Pandemic-related emergency support (level; % of GDP)**

COVID-19 temporary emergency measures				
	2020	2021	2022	2023
BE	4.5	3.0	0.5	0.0
CY	3.5	2.9	0.3	0.0
DE	2.6	4.2	0.8	0.0
EE	1.1	2.3	0.0	0.0
EL	7.5	6.5	1.5	0.0
IE	3.7	2.8	0.7	0.0
ES	3.2	3.1	0.5	0.0
FR	3.3	2.6	0.5	0.0
IT	4.3	3.4	1.1	0.0
LV	2.7	5.0	1.2	0.0
LT	1.5	0.6	0.4	0.0
LU	2.3	0.8	0.1	0.0
MT	5.9	3.2	0.8	0.0
NL	2.4	1.8	0.3	0.0
AT	4.7	4.3	0.8	0.0
PT	1.9	2.0	0.8	0.0
SI	4.8	4.1	1.0	0.0
SK	2.3	3.2	0.8	0.0
FI	2.8	2.0	0.2	0.0
BG	2.8	3.7	1.0	0.0
CZ	2.9	2.0	0.1	0.0
DK	2.6	4.0	0.0	0.0
HR	2.2	1.3	0.1	0.0
HU	3.9	1.9	0.1	0.0
RO	1.6	0.8	0.0	0.0
PL	4.5	2.4	0.7	0.0
SE	3.3	2.0	1.1	0.0
EA	3.3	3.3	0.7	0.0
EU	3.3	3.1	0.7	0.0

Source: European Commission 2023 spring forecast

Table All.10: **Budgetary costs to shelter and integrate people fleeing the war in Ukraine (level; % of GDP)**

Budgetary costs for refugees from Ukraine			
	2022	2023	2024
AT	0.2	0.2	0.2
BE	0.1	0.1	0.1
BG	0.1	0.2	0.2
CY	0.1	0.0	0.0
CZ	0.3	0.2	0.1
DE	0.1	0.1	0.1
DK	0.0	0.0	0.1
EE	0.6	0.8	0.7
EL	0.0	0.0	0.0
ES	0.0	0.0	0.0
FI	0.1	0.3	0.3
FR	0.0	0.1	0.1
HR	0.1	0.1	0.1
HU	0.1	0.1	0.0
IE	0.1	0.2	0.1
IT	0.1	0.0	0.0
LT	0.3	0.3	0.3
LU	0.1	0.1	0.1
LV	0.2	0.3	0.3
MT	0.1	0.1	0.1
NL	0.1	0.1	0.0
PL	0.5	0.2	0.2
PT	0.0	0.0	0.0
RO	0.0	0.0	0.0
SE	0.2	0.1	0.1
SI	0.1	0.1	0.1
SK	0.1	0.1	0.1
EA	0.1	0.1	0.1
EU	0.1	0.1	0.1

Source: European Commission 2023 spring forecast

Table All.11: **Medium-term real GDP potential growth used as reference to compute the fiscal stance indicators (%)**

10-year real GDP potential growth			
	2022	2023	2024
BE	1.5	1.5	1.5
CY	3.0	3.1	2.9
DE	1.0	0.9	0.9
EE	2.9	2.7	2.5
EL	-0.2	0.1	0.3
IE	7.4	7.4	7.0
ES	0.9	1.0	1.0
FR	0.9	0.9	0.9
IT	0.4	0.5	0.5
LV	2.5	2.4	2.3
LT	3.2	3.2	3.2
LU	2.2	2.2	2.2
MT	5.3	5.0	4.7
NL	1.7	1.7	1.6
AT	1.3	1.3	1.3
PT	1.7	1.7	1.7
SI	2.4	2.5	2.7
SK	2.0	1.9	1.9
FI	1.2	1.2	1.2
BG	2.3	2.3	2.2
CZ	2.0	1.8	1.7
DK	1.8	1.7	1.5
HR	2.5	2.5	2.6
HU	3.1	3.2	3.1
RO	3.6	3.5	3.2
PL	3.5	3.4	3.2
SE	1.9	1.9	1.8

Source: European Commission 2023 spring forecast

ANNEX III

Glossary

Automatic stabilisers Features of the government budget that reduce the fluctuations in the economic cycle. For example, unemployment benefits tend to increase and tax revenues tend to decrease during an economic downturn, while most expenditure continues to rise at its trend. 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.

Budget balance The balance of total public revenue and expenditure and in a specific year. 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).

COVID-19 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. Measures with a budgetary impact in 2023 that is below 10% of the initial budgetary impact are considered temporary. Despite being temporary, they are not considered *one-offs* under the EU fiscal framework also due to their multi-annual nature. They are excluded from the computation of the *fiscal stance* by the Commission as they were largely implemented in 2020-21, when most economic activities were restrained due to the health situation and a sizeable part of these measures had a cyclical nature (e.g. support for short-time work schemes in substitution of unemployment benefits). This pandemic-related support is assumed to be fully phased out in 2023, however it still has an important bearing on economic activity in the euro area through pent-up demand.

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

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

Fiscal adjustment A permanent change in the fiscal position of the government. The increase in primary expenditure - net of discretionary revenue measures – relative to 10-year (nominal) potential output growth is used to measure the fiscal adjustment in relation to the fiscal effort requirement of the country-specific recommendations for 2024 (this is identical to the expenditure benchmark, apart from the no 4-year smoothing of GFCF). For the fiscal adjustment in 2024 there is no need to exclude COVID-19 temporary emergency measures (see *fiscal stance*) as they are assumed to have ended in 2022. In this note, the fiscal adjustment in the national budget for 2024 is therefore calculated as follows:

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

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

$$E_t^{FA} = G_t - I_t - U_t - EU\ funds_t - one\ offs_t^G$$

where G_t is general government total expenditure; U_t the cost of (cyclical) unemployment benefits; I_t is interest expenditure; $EU\ funds_t$ is expenditure (or lower revenue) financed by the EU budget (RRF and other funds); 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 (i.e. excluding one-offs as well as COVID-19 temporary emergency measures on the revenue side) and E_t^{FS} is the expenditure aggregate computed as follows:

$$E_t^{FS} = G_t - I_t - U_t - one\ offs_t^G - Covid.\ emerg.\ measures_t^G$$

where G_t is general government total expenditure, including expenditure financed by RRF grants and other EU funds (contributions from national budgets to the EU budget are not considered here, as they are rather stable over time and across Member States); U_t the cost of (cyclical) unemployment benefits; I_t is interest expenditure; Y_t is nominal GDP.

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

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

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

Policy mix The combined impulse to the economy resulting from the fiscal policy stance and the monetary policy stance.

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.

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 around €724 billion in loans (€386 billion) and grants (€338 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*.

Revenue windfalls/shortfalls Revenue windfalls (shortfalls) are estimated through the increase (decrease) in the revenue-to-GDP ratio that is not explained by discretionary measures or transfers from the EU budget. This methodology assumes an elasticity of 1 in the medium term between the increase in revenues and nominal GDP growth.

Snowball effect The net impact of implicit interest rates paid on debt, inflation (GDP deflator), and real GDP growth (that is, the interest rate-growth differential or “r-g”) on debt dynamics.

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

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 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*.

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