Assessment of the fiscal stance appropriate for the euro area

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Main messages of the report

➢ Euro area is enjoying a solid economic expansion. Current economic conditions offer a prime opportunity to create fiscal buffers.

➢ Need to avoid past mistakes when good times were wasted. If opportunity is missed, euro area will be more vulnerable when next shock hits.

➢ No radical shift of fiscal stance, but move from neutral to restrictive fiscal stance is appropriate. Especially high-debt countries need to improve their structural positions.

➢ Implementation of SGP would yield appropriate fiscal stance in 2019.

➢ In parallel, EU fiscal framework needs to be strengthened: An effective stabilisation function to be combined with simpler and stronger fiscal rules.
The ongoing recovery is broad-based and has consistently surprised on the upside. In 2018, euro area GDP (at constant prices) is now expected to be more than 2 percentage points higher than it was at the end of 2016. The outlook for 2019 has been revised up too.
Euro area is enjoying a solid economic expansion

Also thanks to past labour market reforms, the recovery has been job-rich; the rate of unemployment has decline considerably. Broader definitions of unemployment are higher but have also dropped and are close to levels recorded before 2007.

Unemployment is back to levels observed during previous booms

(EA-12 unemployment and output gap)

Source: European Commission
The euro area is in good times

Estimates of the degree of economic slack in the euro area economy support a consistent story: the output gap has been narrowing and is expected to turn positive in the course of 2018-2019.
The euro area is in good times

Real-time output gap estimates are uncertain, but revisions are not random. There is a clear tendency to underrate good times when they happen. We need to learn from the past.

Source: European Commission
Projections for 2018 point to an expansionary fiscal stance (we advised a neutral stance). Unless new measures are taken, in 2019 the budgetary benefits of the expansion will be entirely spent.
The macroeconomic outlook warrants a somewhat restrictive fiscal stance in 2019. Implementing the SGP (as per the CSRs issued in May) would deliver the appropriate outcome. Corrections of current budgetary trends are needed.
Differentiation across countries needed

Worryingly, the fiscal expansion in 2018-2019 emerging from current budgetary trends largely originates in countries with higher sustainability risks. These countries should not miss the window of opportunity to build fiscal buffers and reduce vulnerabilities.

(*) In 2019, the ΔSPB of FR includes a statistical effect of around 0.7% of GDP)
Governance framework needs to be upgraded

**Two complementary elements**

#### Central stabilisation function

- Addressing large symmetric and asymmetric shocks
- Sufficiently funded
- Based on independent economic judgement
- Access conditional on compliance with fiscal rules

#### Reform of Stability and Growth Pact

- Simpler and stronger rules
- Enhanced transparency
- Greater role for independent analysis and advice
- Needed to ensure even-handed assessment of compliance

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European Investment Stabilisation Function: step in the right direction, but narrow focus on country-specific shocks, very limited size, and automatic trigger

Review of fiscal framework currently envisaged only after 2020

The EFB acknowledges the political difficulty of achieving both at the same time. Still, a central stabilisation function will neither work politically nor economically without better EU fiscal rules.
Thank you for your attention