European Fiscal Board

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.

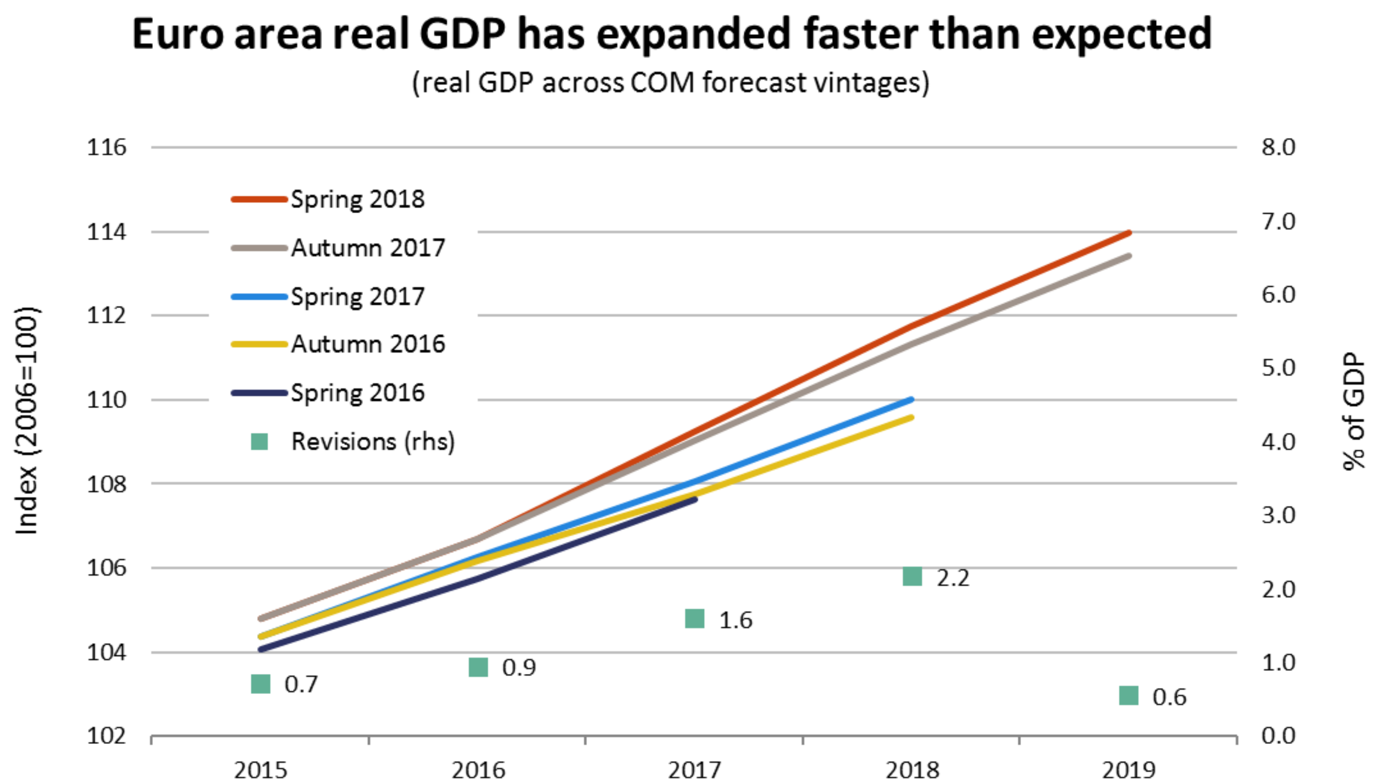
- Need to avoid past mistakes when good times were wasted. If opportunity is missed, euro area will be more vulnerable when next shock hits.

- 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.

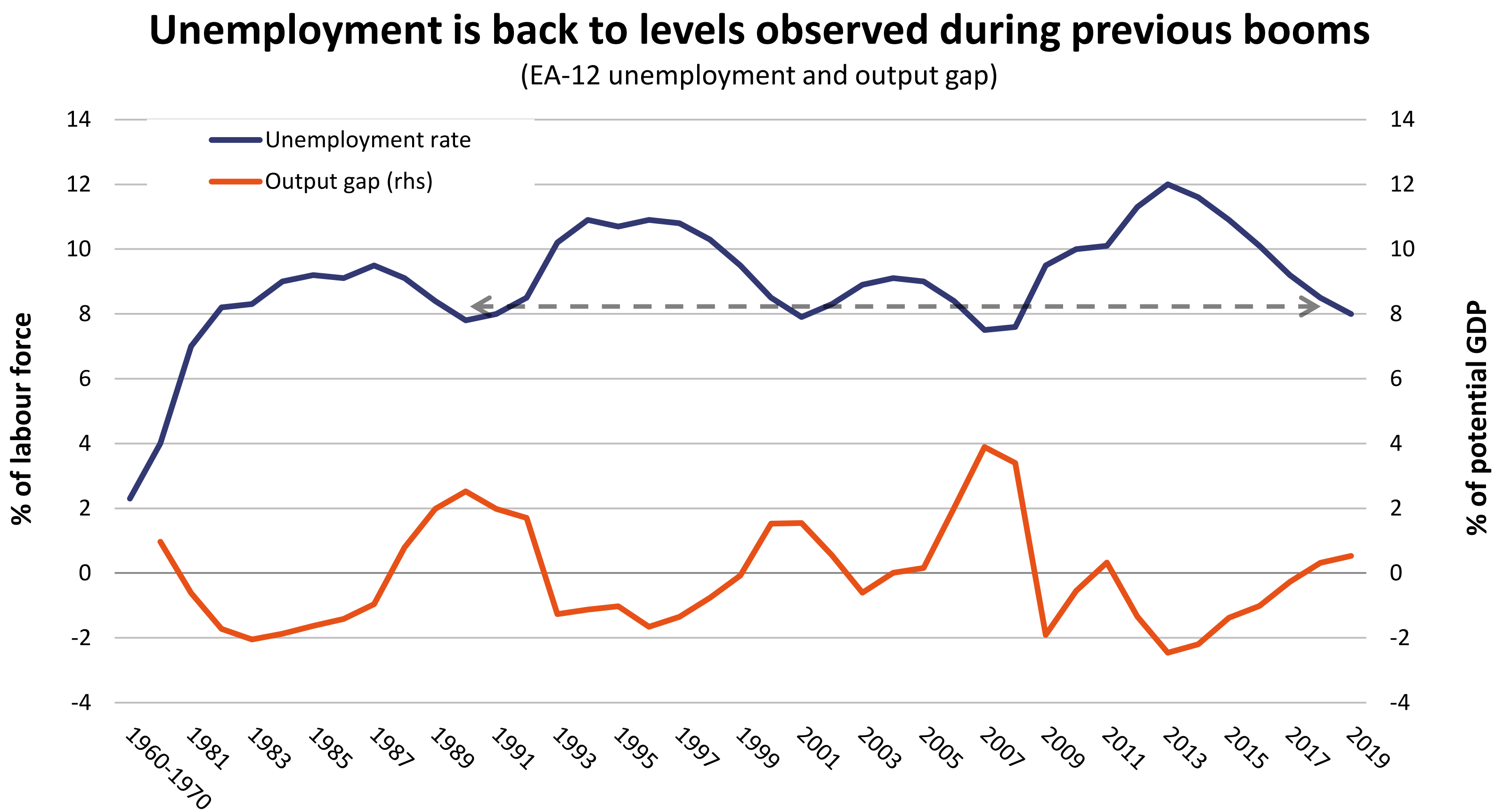
Euro area is enjoying a solid economic expansion



Source: European Commission

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.

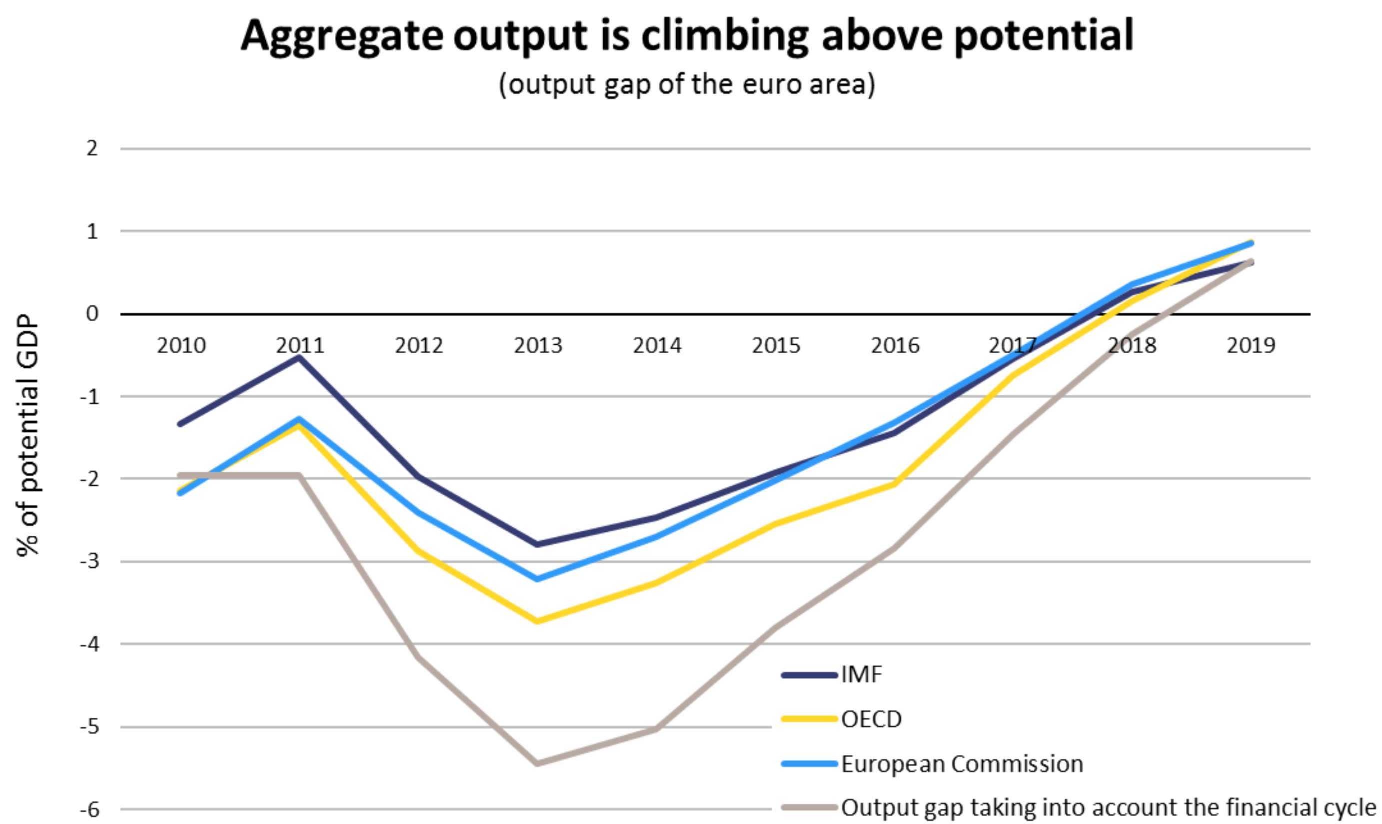
Euro area is enjoying a solid economic expansion



Source: European Commission

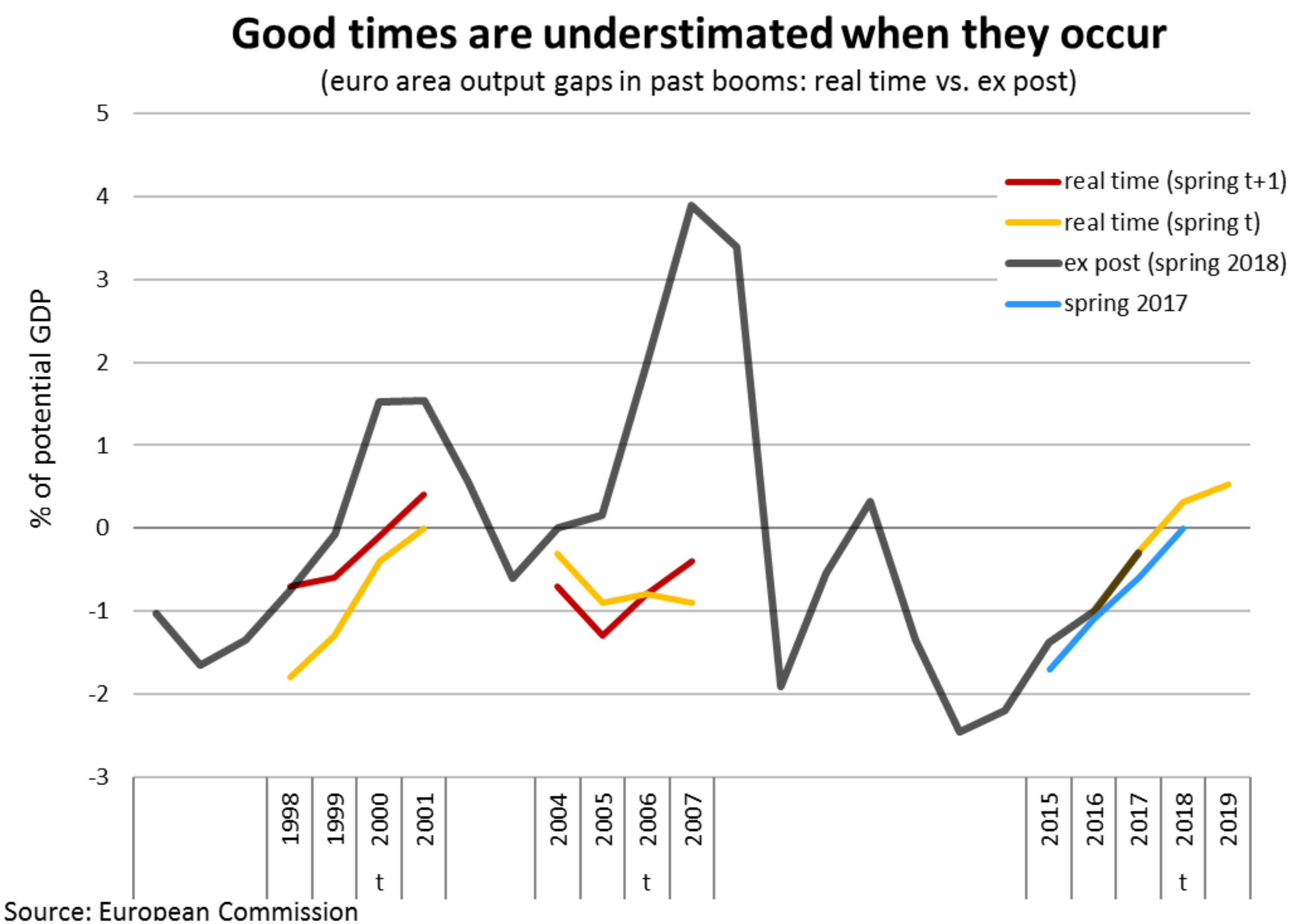
Also thanks to past labour market reforms, the recovery has been job-rich; the rate of unemployment has decline considerably. Broader definitions of unemployment are higher but have also dropped and are close to levels recorded before 2007.

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

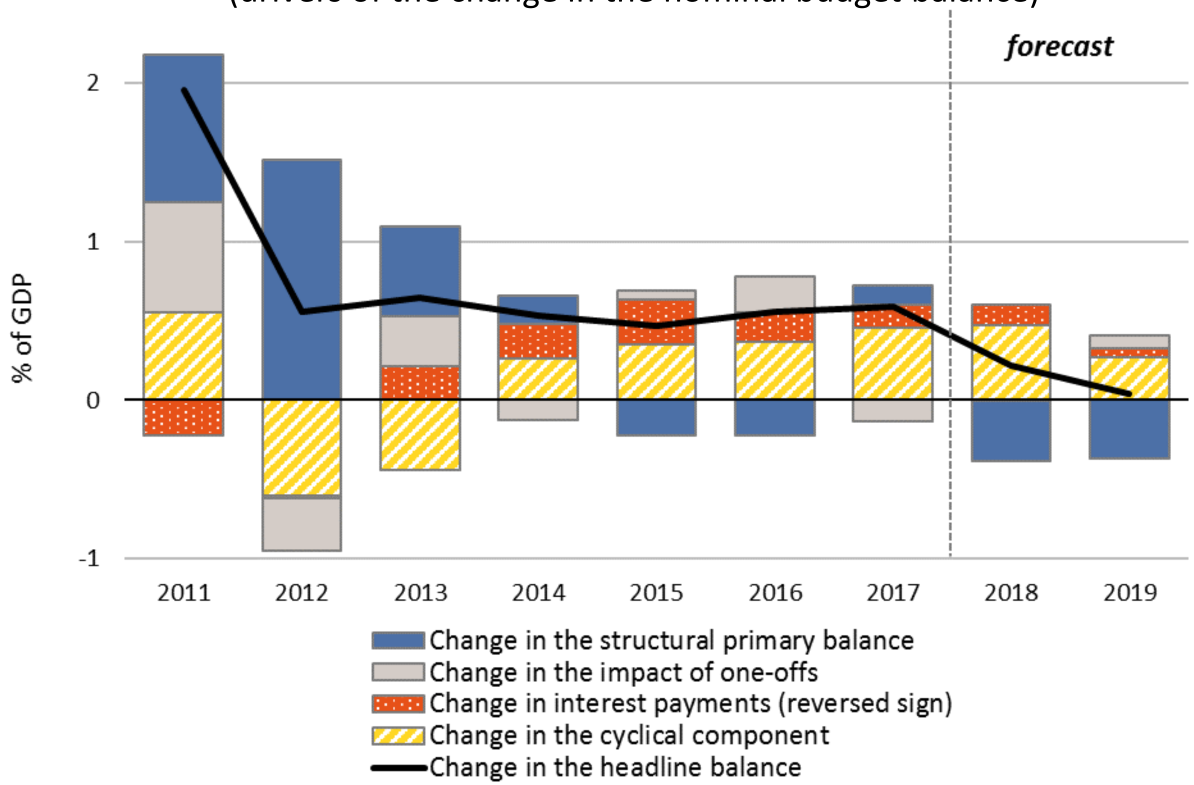


Real-time output gap estimates are uncertain, but revisions are not random. There is a clear tendency to underrate good times when they happen. We need to learn from the past.

Are good times again being wasted?

Discretionary fiscal measures are deteriorating the fiscal position

(drivers of the change in the nominal budget balance)

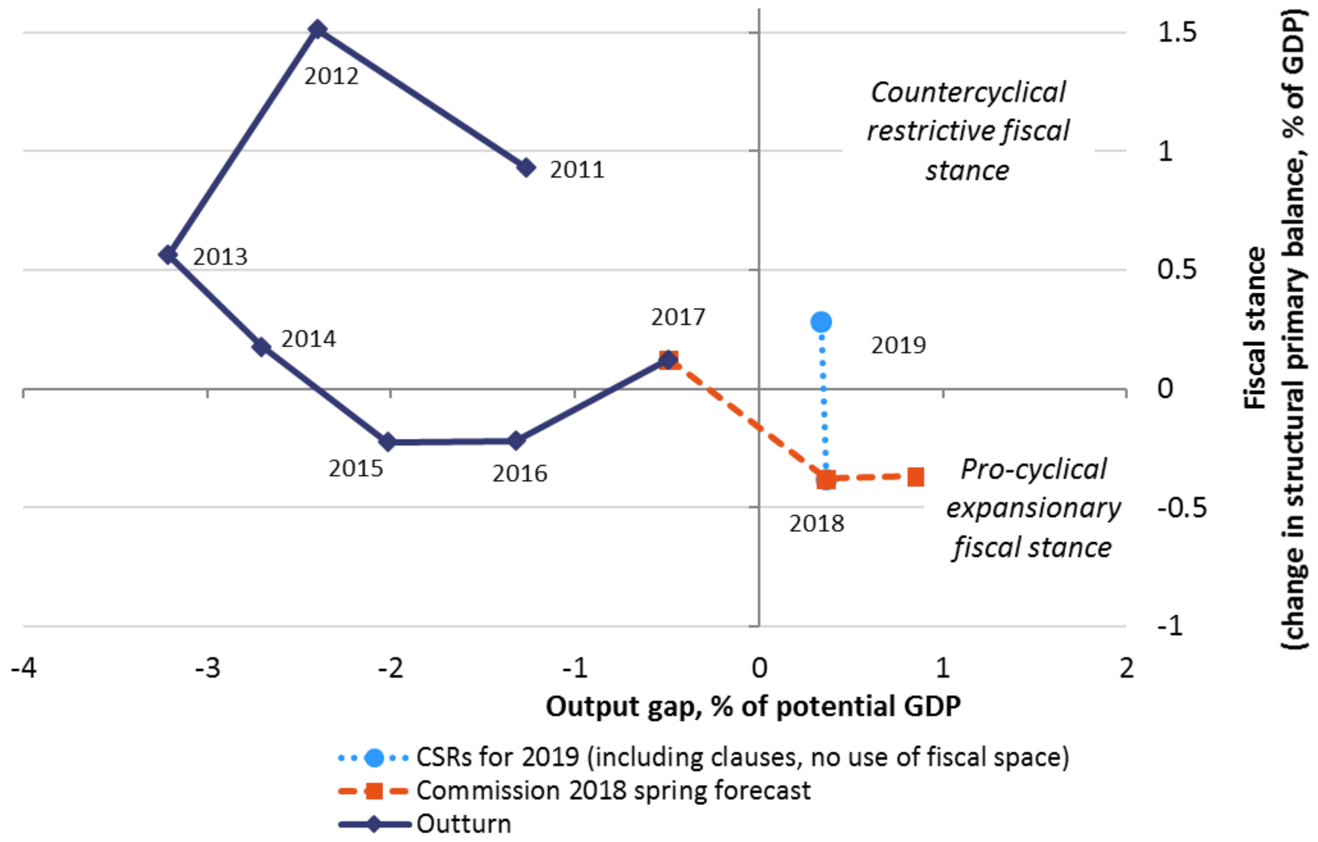


Projections for 2018 point to an expansionary fiscal stance (we advised a neutral stance). Unless new measures are taken, in 2019 the budgetary benefits of the expansion will be entirely spent.

A somewhat restrictive fiscal stance appropriate in 2019

Compliance with the Stability and Growth Pact would be appropriately countercyclical

(fiscal stance in the euro area)

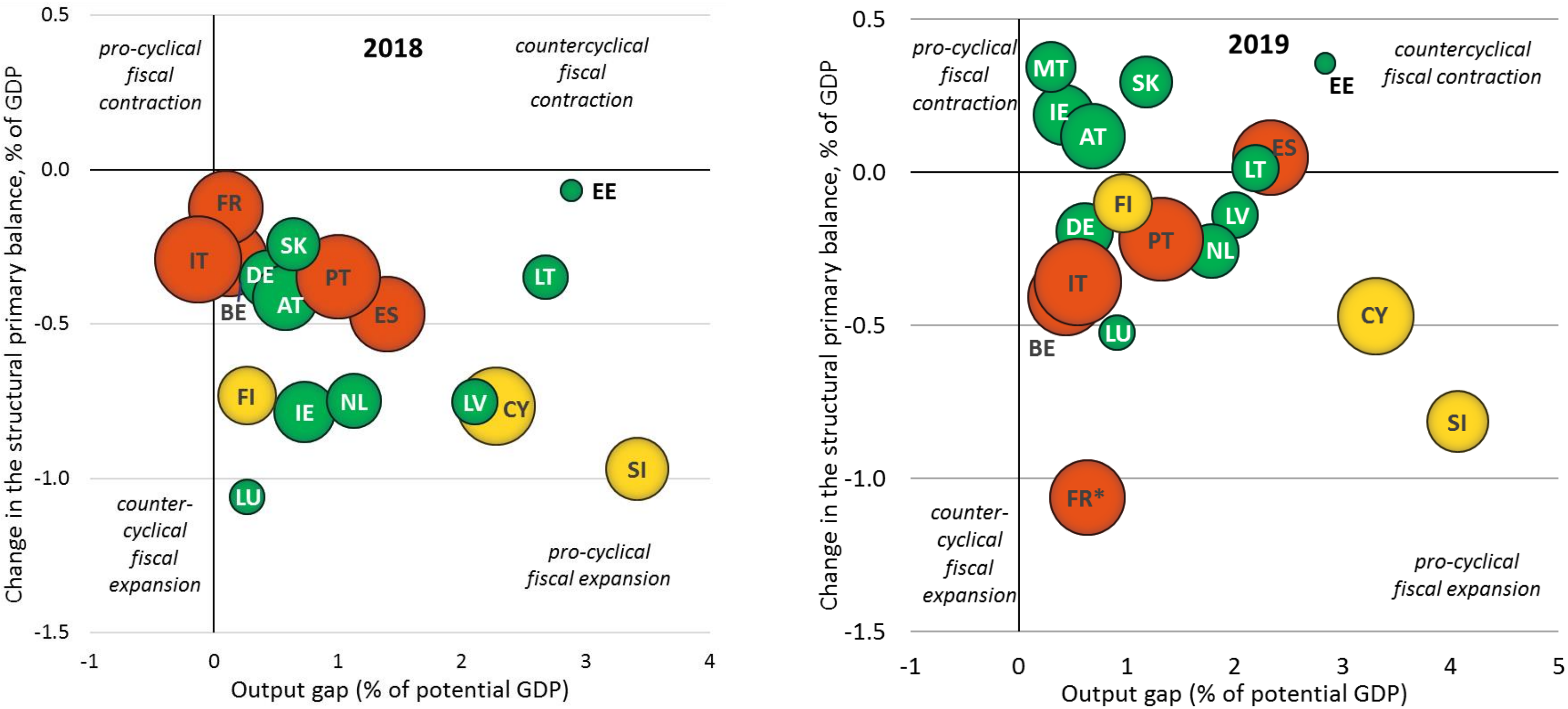


The macroeconomic outlook warrants a somewhat restrictive fiscal stance in 2019. Implementing the SGP (as per the CSRs issued in May) would deliver the appropriate outcome. Corrections of current budgetary trends are needed.

Differentiation across countries needed

Fiscal expansion originates in high-debt countries

(fiscal stance, cyclical conditions and sustainability in euro area Member States; Commission forecast)



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