



# Europe: time for fiscal consolidation

**KEY TAKEAWAYS:** The public finances of Eurozone countries began to improve in 2023 and fiscal consolidation will intensify in most Eurozone countries during 2024. Still, fiscal vulnerability – particularly for the most heavily-indebted countries – will rise over time, leading to a higher probability that public debt will not stabilise. The aim of the new fiscal rules is to ensure the long-term sustainability of public finances, but funding for the green transition could suffer.



**Didier BOROWSKI**  
Head of Macro Policy  
Research - Amundi  
Investment Institute

*“It’s important to start reallocating resources to preserve priority spending now in preparation for tougher times ahead.”*

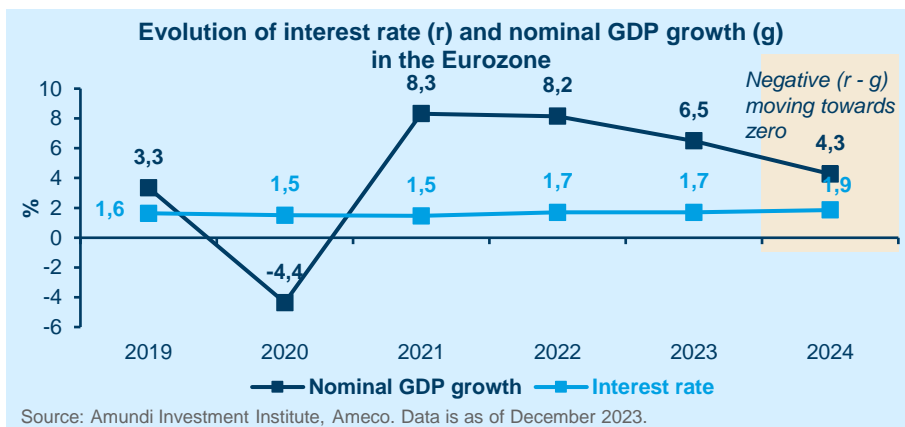
In an environment of weak growth, governments have less budgetary leeway. Indeed, for highly-indebted countries, the rise in effective interest rates paid on debt will increase debt-servicing costs and, all other things being equal, contribute to higher debt-to-GDP ratios. True, the public finances of Eurozone countries began to improve in 2023, with a recovery in tax revenues, helped by inflation, and the gradual removal of support measures. And fiscal consolidation will intensify in 2024. **Based on a change in the cyclically-adjusted primary balance, the fiscal impulse is estimated to rise from -0.3% to -0.85% of GDP in 2024.**

### The growth-rate dynamic will not always remain so favourable

The difference between the interest rate and the GDP growth rate – known as  $(r - g)$  – is still negative in all countries, but is approaching zero. This simple measure sums up the severity of budget constraints. When  $(r - g)$  is equal to zero, the dynamics of the debt/GDP ratio are simple: if the government runs a primary deficit, the debt ratio rises / if it runs a surplus, the debt ratio falls.

**Most Eurozone countries are currently running primary deficits.** As they refinance their debt, the average interest rate on the debt (the effective rate) will reflect the higher long-term market rate. Budget constraints will inevitably tighten, with the  $r-g$  threatening to slip back into positive territory (because of weak growth, disinflation and higher bond yields).

**Public finances are sustainable in Europe, however, fiscal vulnerability will increase over time, particularly for the most heavily-indebted countries.** The probability that public debt will not stabilise is increasing. It is necessary to replenish resources for a rainy day now and to reallocate resources to preserve priority spending. This adjustment must be made very gradually to avoid overly pro-cyclical fiscal measures.





## New fiscal rules: the sword of Damocles hangs over green transition financing

The newly agreed fiscal rules are particularly complex (see box) and far from the initial objective. This complexity is the result of a compromise between governments with initially conflicting positions. Nevertheless, they represent a step forward compared to the old rules. **The main aim is to make governments more accountable and to encourage them to promote reforms and investment. Governments that play the game will benefit from greater flexibility.** The rules will only apply from 2025.

In addition, to avoid a brutal adjustment for the countries that will fall into the Excessive Deficit Procedure (EDP) in 2024 (such as France and Italy), it has been agreed that the increase in interest charges on debt will not be taken into account in the measurement of the structural deficit over the period 2025-27. Budget cuts should thus remain contained over this period.

It is too early to judge the effectiveness of the new fiscal rules and their impact on growth. **It is even more true that it will be quite difficult to reconcile these rules with the huge investments needed to finance the green and digital transition** (€700bn per year according to the European Commission - EC). In the absence of a central fiscal capacity, this new institutional arrangement is unlikely to be more respected than the previous one. The EC will need to be pragmatic.

### Box: Takeaways regarding the new fiscal rules of the Stability and Growth Pact

The rules were approved by EU Member States on 20 December 2023. The European Parliament will examine these rules in the coming weeks. A favourable vote is expected by end Q1 2024 at the latest.

#### The 4-year budget plan

- Each country will have to draw up a 4-year budget plan in collaboration with the European Commission (EC). The EC may extend the adjustment period from 4 to 7 years, provided that the country is willing to implement pro-growth reforms and invest in the areas of green and digital transition.
- As part of this plan, each government will pledge to respect a net expenditure trajectory. This trajectory is based on a debt sustainability analysis (DSA), which enables a tailor-made adjustment plan.

#### Fiscal targets

- After a fiscal adjustment plan (lasting 4 or 7 years), the deficit must not exceed 1.5% of GDP. The aim is to build up a reserve for a rainy day.
- Countries with deficits of between 1.5% and 3% of GDP will also have to undertake further efforts. The reduction of the deficit should be at least 0.4% of GDP per year (if the adjustment period is 4 years) and at least 0.25% of GDP per year (when the adjustment period is extended to 7 years).
- Countries whose debt is between 60% and 90% of GDP will have to reduce their debt ratio by 0.5pp per year over the adjustment period. If the debt exceeds 90% of GDP, the effort will have to be greater (1pp per year) on average over the adjustment period.

#### Excessive Deficit Procedure

- The adjustment plan for net expenditure will be based on the strictest of the three criteria (DSA, deficit or debt). The EC will be responsible for monitoring. If a country deviates from the net expenditure path by more than 0.3% of GDP in one year or by more than 0.6% of GDP in total over the entire adjustment period, the EC will decide whether to initiate an Excessive Deficit Procedure (EDP).
- Defence expenditure receives special treatment (not included in net expenditure).
- The Excessive Deficit Procedure (when the annual deficit exceeds 3% of GDP) is maintained. Many European countries (including France and Italy) will fall under the EDP from 2024. Under this procedure, the adjustment will not relate to the net expenditure path but to the structural deficit, which will have to be cut by 0.5% of GDP each year until it falls below 3%.
- In the event of non-compliance with the EDP, the fine will be limited to 0.05% of GDP, a much lower level than previously. The agreement implicitly relies on a "name and shame" procedure by the EC to encourage Member States to respect their commitments.

## IMPORTANT INFORMATION

This document is solely for informational purposes.

This document does not constitute an offer to sell, a solicitation of an offer to buy, or a recommendation of any security or any other product or service. Any securities, products, or services referenced may not be registered for sale with the relevant authority in your jurisdiction and may not be regulated or supervised by any governmental or similar authority in your jurisdiction.

Any information contained in this document may only be used for your internal use, may not be reproduced or redisseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices.

Furthermore, nothing in this document is intended to provide tax, legal, or investment advice.

Unless otherwise stated, all information contained in this document is from Amundi Asset Management SAS and is as of 12 January 2024. Diversification does not guarantee a profit or protect against a loss. This document is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The views expressed regarding market and economic trends are those of the author and not necessarily Amundi Asset Management SAS and are subject to change at any time based on market and other conditions, and there can be no assurance that countries, markets or sectors will perform as expected. These views should not be relied upon as investment advice, a security recommendation, or as an indication of trading for any Amundi product. Investment involves risks, including market, political, liquidity and currency risks.

Furthermore, in no event shall any person involved in the production of this document have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages.

Date of first use: 12 January 2024.

Document issued by Amundi Asset Management, "société par actions simplifiée"- SAS with a capital of €1,143,615,555 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90-93 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – [www.amundi.com](http://www.amundi.com)

Photo credit: ©iStock/Getty Images Plus – Bloomberg Creative.

### Amundi Investment Institute contributors

**AINOUZ Valentine,**

*Head of Global Fixed Income Strategy, CFA*

**BERARDI Alessia,**

*Head of Emerging Macro and Strategy Research*

**BERTHON Jean-Baptiste,**

*Senior Cross-Asset Strategist*

**BERTONCINI Sergio,**

*Senior Fixed Income Strategist*

**BOROWSKI Didier,**

*Head of Macro Policy Research*

**CARULLA Pol,**

*Investment Insights and Client Division Specialist*

**CESARINI Federico,**

*Head of DM FX, Cross Asset Strategist*

**DHINGRA Ujjwal,**

*Investment Insights and Client Division Specialist*

**DI SILVIO Silvia,**

*Cross Asset Macro Strategist*

**DROZDZIK Patryk,**

*Senior EM Macro Strategist*

**GEORGES Delphine,**

*Senior Fixed Income Strategist*

**GIAUSA Gabriele,**

*Junior Macro Strategist*

**HERVÉ Karine,**

*Senior EM Macro Strategist*

**HUANG Claire,**

*Senior EM Macro Strategist*

**MIJOT Eric,**

*Head of Global Equity Strategy*

**PORTELLI Lorenzo,**

*Head of Cross Asset Strategy, Head of Research at Amundi Italy*

**PRADHAN Mahmood,**

*Head of Global Macroeconomics*

**ROSENBERG Anna,**

*Head of Geopolitics*

**USARDI Annalisa,**

*Senior Economist, CFA*

**VARTANESYAN Sosi,**

*Senior Sovereign Analyst*

### Chief editors

**DEFEND Monica,**

*Head of Amundi Investment Institute*

**MORTIER Vincent,**

*Group Chief Investment Officer*

### Editors

**BERTINO Claudia,**

*Head of Amundi Investment Insights & Publishing*

**FIOROT Laura,**

*Head of Investment Insights & Client Division*

### Deputy editors

**PANELLI Francesca,**

*Investment Insights & Client Division Specialist*

**PERRIER Tristan,**

*Macroeconomist and Investment Insights Specialist*

**GALLARATE Gianluca,**

*Investment Insights & Publishing*