During the past decade, euro area fiscal policy has been marked by the ongoing reduction in the budget deficit from the peak of 6.2% of GDP in 2009 to the forecast figure of 0.6% for 2018. The correction of the budgetary imbalance was the outcome, first, of a package of discretionary structural measures involving expenditure cuts and tax increases; and further, of the effects of the pick-up in activity and of the reduction in interest rates. This ultimately prompted a decrease in the public debt ratio from 94% of GDP in 2014 to below 87% of GDP in 2018.

The budgetary plans for 2019 submitted by the euro area countries to the European Commission suggest a change in tack in the area's fiscal policy towards a slightly expansionary stance, i.e. one conducive to demand growth. The deficit is thus expected in 2019 to post its first increase in the past decade as a percentage of GDP (0.2 pp) to stand at 0.8%.[1] That would not prevent a fresh cut in debt, to 85.1% of GDP, assisted by the economic expansion and the pick-up in inflation.[2] In structural terms, the increase in the deficit will be somewhat greater (0.3 pp), placing it at 1% of potential GDP[3] (Charts 1 and 2).

While on a very modest scale, this expansionary stance is in notable contrast to the recommendation published last July by the European Fiscal Council. This body, taking into consideration the robust pace of growth of activity in most euro area countries and the still-high levels of public debt, advised maintaining a restrictive fiscal policy, especially in the countries with high debt levels, that would provide for budgetary room for manoeuvre so as to address adverse future situations.[4]

Country by country, the fiscal policy stance in 2019 is, in most cases, expansionary or neutral, in a setting in which positive output gaps prevail (Chart 3). On these estimates, there would only be five countries (in addition to Greece) for which fiscal policy would act in a countercyclical fashion in 2019: France[5], Austria, Finland, Estonia and Latvia. Among the countries projected to have a more lax budgetary policy are some, such as Italy and Cyprus, that also have high debt ratios (Chart 4).[6] Conversely, it is worth noting the fiscal expansion planned by some countries which, having posted low deficit and debt levels, have greater fiscal space, Germany and the Netherlands being cases in point.

Italy is the country planning a more expansionary fiscal stance, with an increase in its structural deficit of close to 1% of potential GDP (Chart 2). This is in contrast to its commitment under the Stability and Growth Pact (SGP) to a 0.6 pp adjustment to its deficit.[7] This breach, along with that relating to the debt reduction criterion, whose ratio, on European Commission November 2018 forecasts, is expected to stand at 131% of GDP in 2019, has given rise to the Commission's recommendation that an Excessive Deficit Procedure based on debt be initiated.[8] That has led the government to reconsider some of the measures planned.

Given the environment of limited fiscal space currently characterising the euro area, the appropriate composition of fiscal policy measures is vital as far as the instruments used are concerned.[9] The fiscal impulse inferred by the aggregation of draft budgetary plans for 2019 stems in full from the revenue side, while expenditure offers a more neutral aspect.[10] The expansionary measures affecting the expenditure side include most notably, the increase in public investment (following the cut observed in the wake of the crisis) and in welfare benefits, especially in Germany and Italy[11] (see Chart 5). The reduction in tax revenue in 2019 stems above all from social contributions, which have generally fallen across the board, most notably in France.[12] In terms of the revenue ratio, this has been offset in part by an increase in indirect taxation, which chiefly affects France, Spain and the Netherlands (see Chart 6).

1 The aggregate budgetary magnitudes for the area as a whole mask substantial heterogeneity from country to country. Eleven members project a surplus or balanced budget for 2019, while of the eight countries forecasting a deficit for the coming year, only France and Italy foresee an increase on 2018. It is indeed these two countries that project the highest deficits, although neither exceeds the reference value of 3% of GDP.

2 In its November projections, the European Commission coincides with the draft budgetary plans as regards the deficits forecast for 2018 and 2019; for debt, meanwhile, it envisages a somewhat greater reduction in 2018 and a slightly lower one in 2019, when debt is expected to stand at 84.9% of GDP.

3 Estimated by the European Commission, using the common methodology for the calculation of potential GDP, based on budgetary planning data. For the area as a whole it coincides practically with that published in November 2018 by the European Commission on the basis of its own forecasts. However, according to these forecasts, if Italy is excluded the euro area's fiscal policy stance in 2019 will be practically neutral, with an increase in the structural deficit of 0.1 pp of potential GDP.

4 European Fiscal Board (2019). Assessment of the prospective fiscal stance appropriate for the euro area in 2019.

5 France's budgetary plan does not include the government's recently announced expenditure-increasing measures.

6 The budgetary plans of 10 countries contain debt ratios that exceed the 60%-of-GDP threshold. Among these, two (Greece and Italy) exceed 120%, with the Portuguese debt ratio just below the threshold in 2019, and with another four members (Belgium, France, Spain and Cyprus) with ratios close to 100%.

7 Specifically, Italy projects an increase of 0.9 pp in its structural deficit, to 2.6% of potential GDP. The European Commission estimates an even higher structural deficit for Italy, rising from 1.8% of potential GDP in 2018, to 3% in 2019.

8 The Council should decide within four months whether it approves this Procedure, following the opinion of the Economic and Financial Committee and the subsequent submission to the Council and the European Parliament of a new report by the Commission with the details of the adjustment programme.

9 See Chapter 4 of the Banco de España *Annual Report 2016*.

10 The cyclically adjusted expenditure ratio holds at 47.1% of potential GDP, while the cyclically adjusted revenue ratio falls by 0.4 pp to 45.8% of potential GDP.

11 In Italy's case, the bringing forward of the minimum retirement age and the introduction of the "Citizen's Income" account for 0.7 pp of GDP.

12 The conversion of the tax credit for competitiveness and employment (CICE by its French acronym) into a permanent reduction in payroll charges accounts for approximately 0.8 pp of French GDP.

Chart 1
FISCAL OBJECTIVES OF DRAFT BUDGETARY PLANS FOR 2019 IN THE EURO AREA AND ITS MEMBER STATES (a)

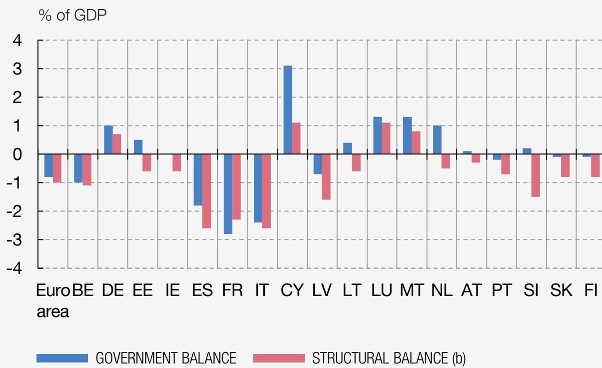


Chart 2
BREAKDOWN OF THE CHANGE IN THE BUDGET BALANCE FOR 2019 IN THE EURO AREA AND ITS MEMBER STATES (a)

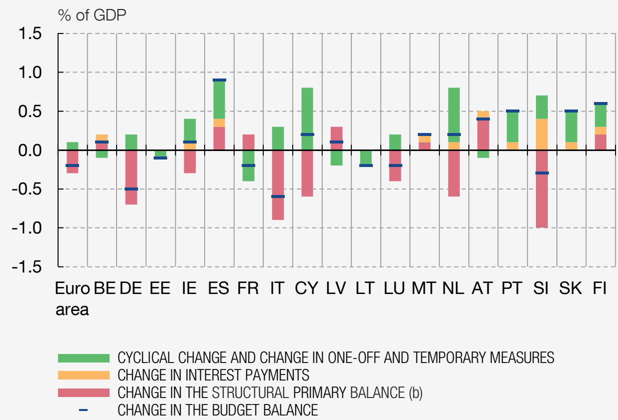


Chart 3
FISCAL POLICY STANCE AND OUTPUT GAP. DRAFT BUDGETARY PLANS FOR 2019 (a)

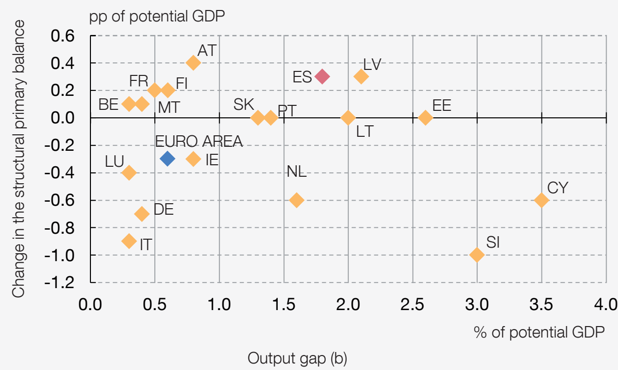


Chart 4
FISCAL POLICY STANCE AND PUBLIC DEBT. DRAFT BUDGETARY PLANS FOR 2019 (a)

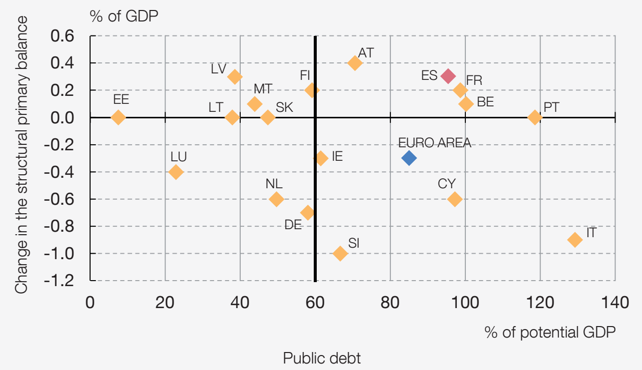


Chart 5
CHANGES IN THE MAIN TYPES OF EXPENDITURE. DRAFT BUDGETARY PLANS FOR 2019 (a)

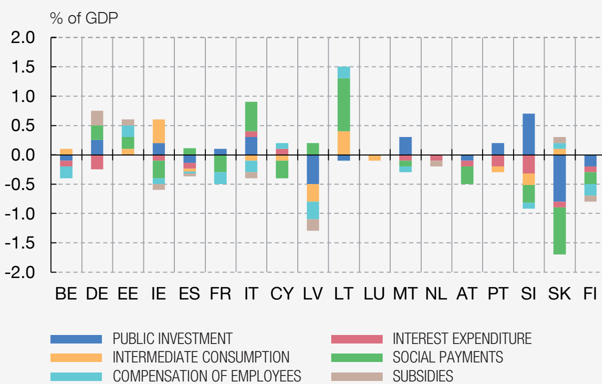
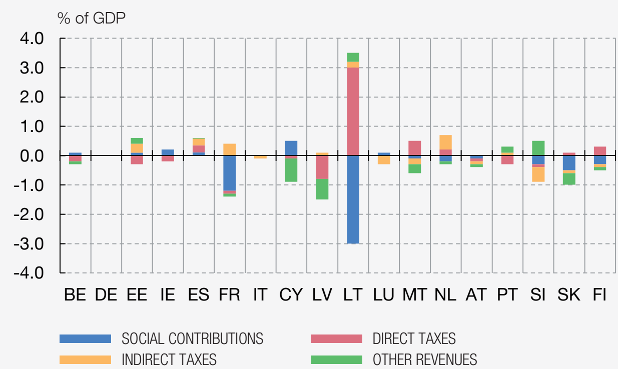


Chart 6
CHANGES IN THE MAIN TYPES OF REVENUE. DRAFT BUDGETARY PLANS FOR 2019 (a)



SOURCE: European Commission.

a The data for Greece are not depicted so as not to distort the charts.
b European Commission estimate.