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“Macroeconomic and fiscal developments in the EU: an overview of the 2025 Annual Progress Reports”

Summary

The Focus published by the Italian Parliamentary Budget Office (PBO) analyses the macroeconomic and public finance outlook of EU countries for 2024-25, with particular attention to Italy, France, Germany and Spain. The analysis compares data from the Annual Progress Reports (APR) with those from the Medium-Term Fiscal-Structural Plans (MTP), both required under the new EU economic governance framework.

Macroeconomic Outlook in the EU and Euro Area

In 2024, the EU economy showed resilience in a context of significant global uncertainty marked by geopolitical tensions, volatility in energy and currency markets, and a gradual reduction in inflationary pressures. GDP grew by 1.0 per cent in the EU and by 0.9 per cent in the euro area, although there were marked disparities among Member States: Spain recorded robust economic growth, Germany remained in recession, while countries such as Denmark, Malta and Croatia achieved strong expansions. Italy experienced moderate growth (0.7 per cent), falling short of the euro area average, while the French economy expanded by 1.1 per cent.

On the inflation front, GDP deflator-based inflation in the euro area averaged around 3.0 per cent in 2024, with significant heterogeneity across countries. Price increases were more pronounced in Germany and Spain, whereas France and Italy registered lower inflation, notably due to declining energy prices and subdued domestic demand in Italy. For 2025, despite forecasts reflecting a worsening international environment, all EU countries except Austria and Germany expect positive growth. Ireland and Malta lead growth projections. Among major countries, Spain continues to show strong momentum (2.6 per cent), while France and Italy anticipate more moderate expansion at 1.1 and 0.7 per cent respectively. Germany revised its outlook downward in its July MTP, now expecting stagnation.

For 2025, forecasts project continued but uneven growth across the EU, with all countries except Austria and Germany expected to report positive GDP growth rates. Ireland and Malta are forecast to lead in growth. Among the largest economies, Spain is set to confirm its strong dynamism (2.6 per cent), while France and Italy are expected to post more moderate increases (1.1 and 0.7 per cent, respectively). Germany, according to its July MTP, revised its outlook downward and now anticipates stagnation.

The GDP deflator-based inflation is projected to decline further in 2025 but will remain uneven among Member States. Estimates point to a gradual convergence towards the ECB target, with the EU and euro area average deflator rising by 2.3 per cent. Among the principal economies, projections range from 1.4 per cent for France—supported by falling energy prices—to 2.7 per cent in Germany. Italy's inflation trajectory is expected to align with the European average, while Spain should experience slightly higher inflation due to rising consumption and wages.

Developments in budget balances and public debt

In 2024, the average government deficit in the euro area declined to 3.1 per cent of GDP (from 3.5 per cent in 2023), primarily as a result of revenues exceeding expectations in a context of moderate growth, which offset increasing interest expenditure. The EU average stood at 3.2 per cent. However, substantial disparities remain: eleven Member States exceeded the 3 per cent threshold, with the highest ratios in Romania (9.3), Poland (6.6) and France (5.8). By contrast, Denmark, Cyprus and Ireland achieved significant surpluses. Italy's deficit improved sharply with respect to 2023 reaching 3.4 per cent, due to the phasing out of the *Superbonus* scheme and higher tax revenues, outperforming the MTP estimates.

France recorded a further rise in its deficit, reflecting increased current expenditure and interest payments; Spain and Germany also registered worse-than-expected deficits, in Spain's case due to extraordinary flood-related spending (3.2 per cent), and in Germany, increased spending at the *Länder* and social security level outweighed gains in the federal budget.

Looking at primary balances, Italy achieved a surplus of 0.4 per cent of GDP - its first since the start of the pandemic - supported by higher revenues. France improved over PSB estimates but still posted a primary deficit of 3.7 per cent, due to weaker revenue growth and higher social spending. Spain and Germany reported greater-than-expected primary deficits, at 0.7 and 1.6 per cent, respectively.

Debt ratios in 2024 show great variation across Member States. The average government debt level was 82.3 per cent of GDP in the EU and 88.9 per cent in the euro area. Greece maintained the highest debt burden (153.6 per cent), followed by Italy (135.3), and France (113.0). Public debt trends outperformed expectations in Italy, Germany and Spain: Italy's debt-to-GDP ratio fell to 135.3 per cent, 0.5 points lower than PSB projections, thanks to a primary surplus and a higher GDP deflator; Germany's ratio was 62.5 per cent, lower than forecast due to favourable inflation and better stock-flow adjustments; Spain's debt decreased to 101.8 per cent, driven by the snowball effect and positive stock-flow factors. France's debt rose by 3.2 percentage points to 113.0 per cent, as previously forecast, reflecting negative stock-flow adjustments despite some primary balance improvement.

Looking to 2025, a slight deterioration in balances is expected. The euro area's average deficit should rise to 3.4 per cent of GDP, whereas the one of EU would increase to 3.5 per cent, influenced also by Germany's increased planned borrowing following the activation of the national safeguard clause for defence purposes. Twelve countries are forecast to exceed the 3 per cent threshold, with the highest deficits in Romania, Poland and Belgium. Italy predicts a 3.3 per cent deficit, below the EU average and consistent with MTP projections. The average primary balance will remain negative (-1.4 per cent of GDP) in the euro area, but Italy is expected to maintain a surplus of 0.7 per cent.

Debt levels are projected to edge higher in 2025, with the EU average at 83.6 per cent, and the euro area at 90.2 per cent. Italy will retain the second highest ratio (136.6 per cent), after Greece. More in details, among the largest euro area countries, France's deficit target was revised last January through an amendment to the MTP from 5.0 to 5.4 per cent of GDP. This revised target was subsequently confirmed in the APR. In this context, the year-on-year fiscal adjustment is largely driven by temporary revenue windfalls and a loosening of previous expenditure restraint measures. The debt-to-GDP ratio is expected to increase further by 3.2 percentage points reaching 116.2 per cent. Spain targets a 2.8 per cent deficit, above the PSB estimate, mainly owing to flood response measures, with debt slightly declining but still over target. In its recently presented PSB, Germany, following constitutional reform of the debt brake and activation of the safeguard clause to finance defence expenditures, raised its programmatic deficit to 3.3 per cent (from 1.8 in the DBP), with public debt reaching 63.9 per cent, higher than what was anticipated in October.

Net expenditure trends and fiscal surveillance

The monitoring of net expenditure growth financed by national resources - the key indicator under the new EU economic governance - reveals marked heterogeneity among Member States. Only about half comply with the Council's recommended annual limit for 2025, while a higher share meets the cumulative constraint for 2024-25. Italy is in line with the maximum annual cap (1.3 per cent) and, regarding the 2024-25 period, reports a cumulative net expenditure reduction above the required threshold (0.9 per cent versus 0.7 per cent). France and Spain slightly exceed the recommended 2025 annual growth rate (by about 0.1 percentage points), while still complying with the cumulative cap. Germany, after activating the safeguard clause for defence spending, estimates net expenditure growth at 4.4 per cent, well above its previous DPB targets.

On the basis of these results, the European Commission has suspended the excessive deficit procedure (EDP) for six countries, including Italy and France, on account of their compliance with the adjustment paths and appropriate use of flexibility clauses for those countries who requested its activation. Among EDP countries, only Romania shows a significant deviation (1.7 per cent of GDP in cumulative terms), not compliant with earlier

recommendations. For other non-EDP countries, assessments remain broadly positive, though the European commission recommended enhanced surveillance for some of them. These reviews are still preliminary and will be updated in the autumn. The final assessment of compliance with the 2025 and cumulative 2024-25 expenditure paths will be possible only in spring 2026, once actual data for 2025 become available.

Fiscal stance

In 2024, most Member States adopted restrictive fiscal policies, with Italy implementing the most substantial structural consolidation. Germany pursued procyclical policies, and France a neutral stance. On the contrary, for 2025, nineteen countries plan predominantly expansionary, countercyclical measures. Through the activation of the safeguard clause and an infrastructure investment programme, Germany is projected to follow a countercyclical expansionary path. France, in turn, is set to implement a procyclical restrictive policy, while Italy and Spain will continue with countercyclical restrictions, though far more moderate in Italy than in 2024.

EU Council recommendations on fiscal policy and defence spending

On 8 July, the Council of the European Union adopted the Country-Specific Recommendations (CSRs), placing among its common priorities the strengthening of defence spending capacity, to be achieved while safeguarding debt sustainability. The Council approved the activation of the national safeguard clause for 15 Member States, allowing a temporary exceedance of net expenditure ceilings up to 1.5 per cent of GDP annually for defence-related outlays, until 2028. Germany's request for activation will be considered together with its PSB submitted at the end of July.

All Member States were recommended to respect the maximum net expenditure growth rates established in the Council-endorsed MTPs, a necessary condition for closing excessive deficit procedures for countries under EDP, such as Italy and France. Countries whose MTPs are based on seven-year adjustment plans -including Italy, France, Spain, and Germany - were further reminded of their obligation to implement reforms and investments specified in their respective Council-endorsed MTPs.

For Italy, the Council called for growth-oriented tax reform, a reduction in the tax wedge and inefficient tax expenditures, cadastral value revisions, and enhancement of public spending quality, particularly in response to demographic ageing. Spain was urged to revise its tax system to reduce labour taxation. France, although not receiving specific fiscal CSRs, was advised by the Commission to be prepared for potential corrective measures. Germany, having recently submitted its PSB, was encouraged to strengthen

defence spending while limiting the growth of net expenditure and to improve the efficiency of both the pension system and public spending.

Finally, the Eurogroup highlighted the need to reinforce European defence capability, recommending prudent use of the safeguard clause and a focus on productive investments to support economic growth and long-term sustainability.