EXECUTIVE SUMMARY

An elusive recovery unable to solve the social crisis

Nearly nine years after the meltdown of the financial system of developed countries followed by the euro debt crisis in 2012, recovery in Europe finally started in late 2014. We expect that economic growth is going to slow down in the EU in 2017 (1.6% after 1.9 % in 2016) and in 2018 (1.5%) as tailwinds are turning into headwinds. Brexit is likely to hit UK growth and will have negative, but limited, contagion effects to the rest of the EU. Oil prices are up again and not much more can be expected in terms of competitiveness gains through the exchange rate channel. More importantly the slowdown of international trade and of emerging countries’ growth is weakening external demand to the EU and hence another positive factor is waning.

The aggregate fiscal stance for the euro area will be neutral in 2017, but the fiscal adjustment will resume in 2018. This movement will progressively reverse the positive fiscal impulse of 2015 and 2016. A positive fiscal stance has just been recommended by the European Commission. For 2017, they suggest a fiscal expansion of up to 0.5% of GDP. This is surely a welcome change in approach, as it stresses the need to adopt a global view on the policy mix in the euro area. However, this objective is not compatible with the current country level policy decisions. In particular, at the time of writing it does not seem likely that Germany will heed the commission’s call and make use of available fiscal space. In 2017 fiscal policy according current national plans will continue to weigh on GDP growth even if the aggregate fiscal stance is neutral: positive fiscal impulses are concentrated in countries where there is no activity slack —leading to a low multiplier effect— while fiscal consolidation persists in countries with significant economic slack and a high fiscal multiplier. This shows that the European Semester should not focus exclusively on the aggregate change of the structural balance, without a comprehensive discussion about its geographical distribution and macroeconomic impact.