

CAN THE NEW FISCAL FRAMEWORK HANDLE RISING GEOPOLITICAL UNCERTAINTY?

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ESM PERSPECTIVE – UNCERTAINTY AND RISKS



Stability and Growth Pact:
Achievements and gaps of the new framework

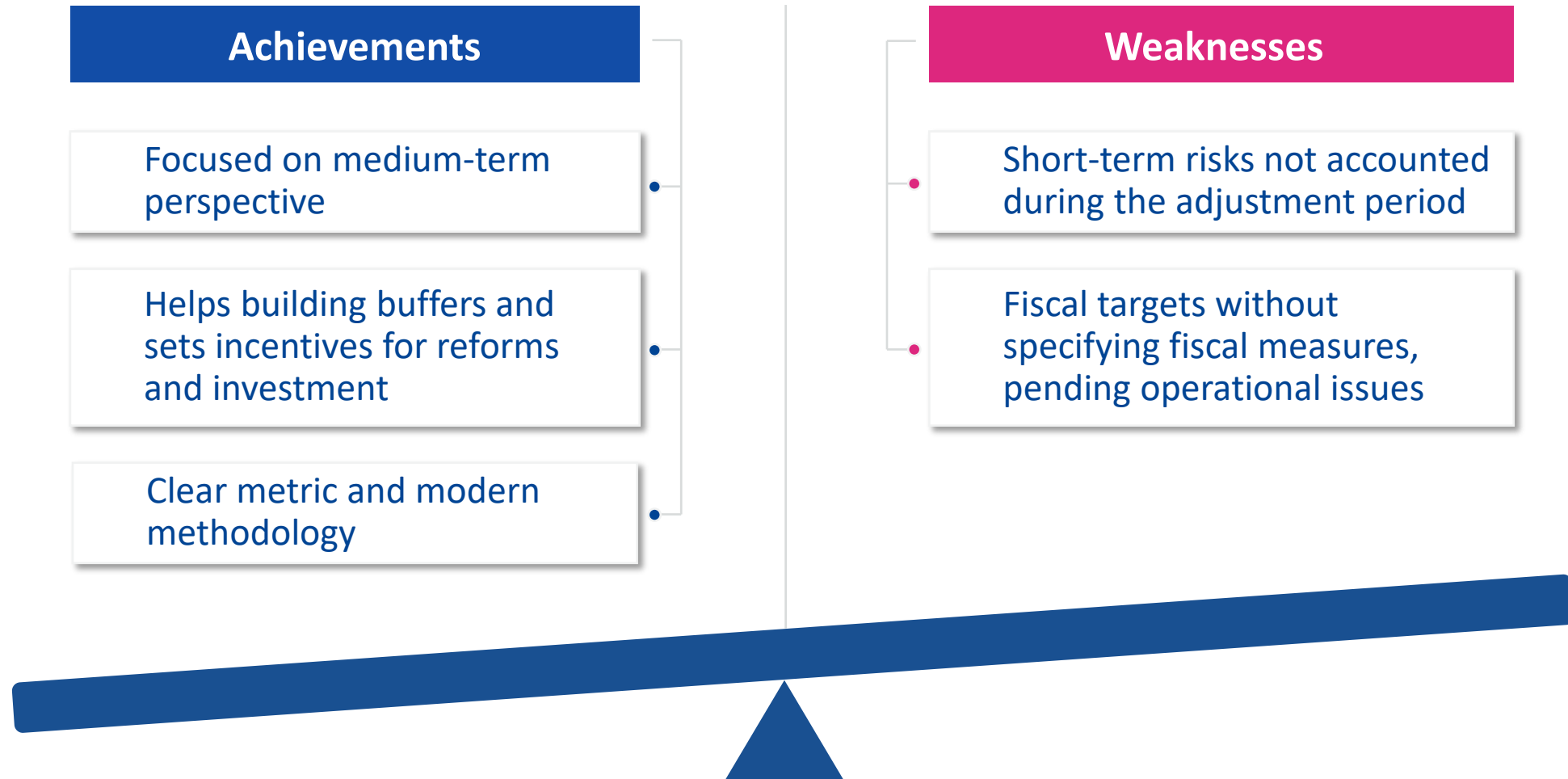


Next crucial steps

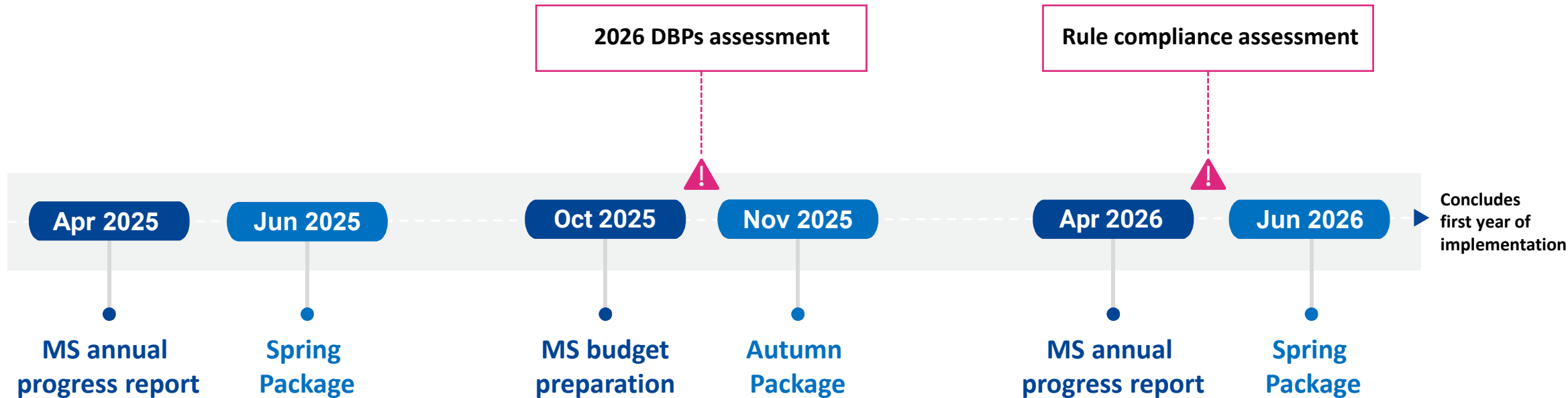


Risks & Challenges:
The case of an adverse US policy shock

NEW FISCAL FRAMEWORK: BIG STEP FORWARD, YET STILL BEARING RISKS



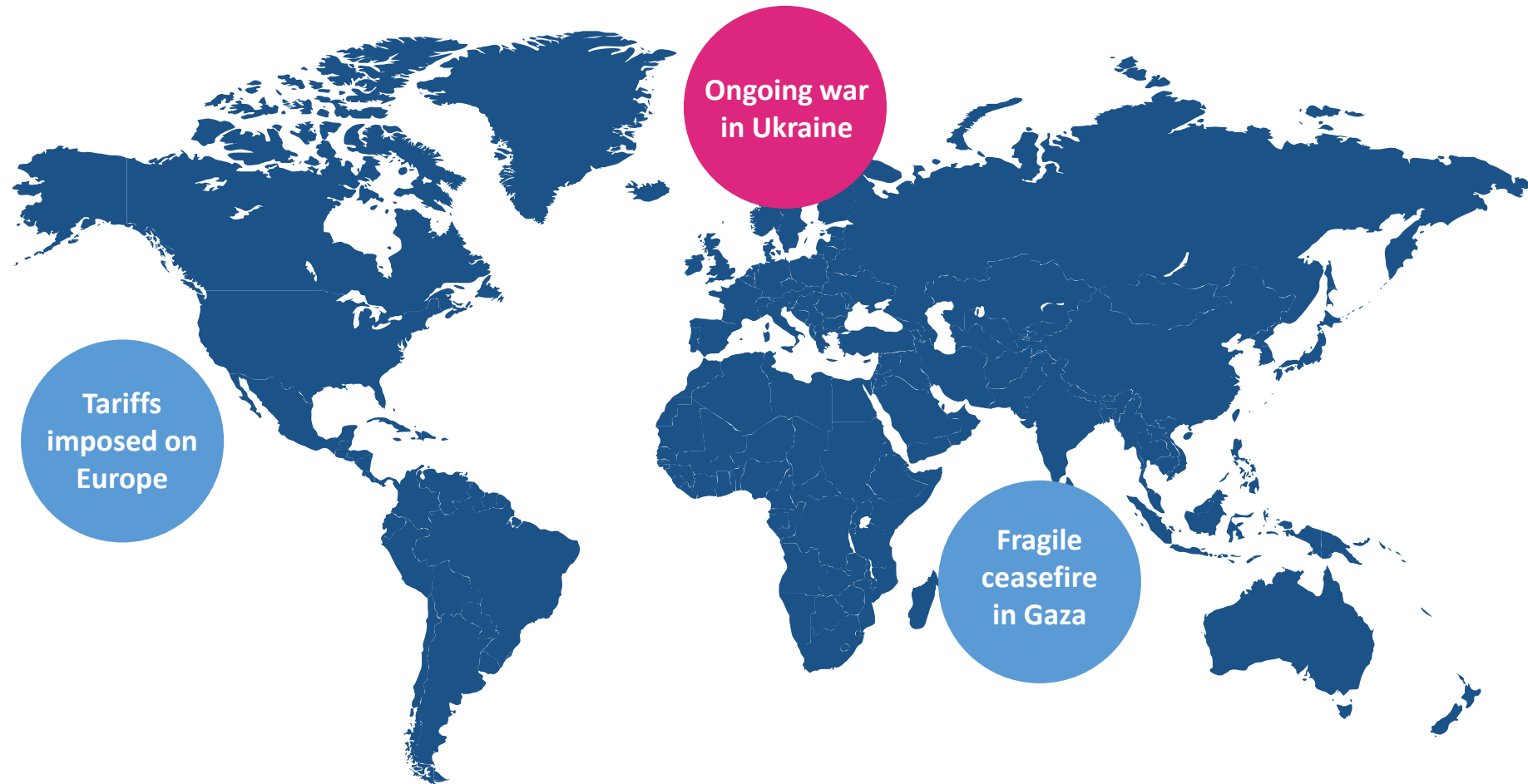
IMPLEMENTATION ON TRACK, WITH FEW CRITICAL STEPS LEFT TO COMPLETE FIRST CYCLE



Note:

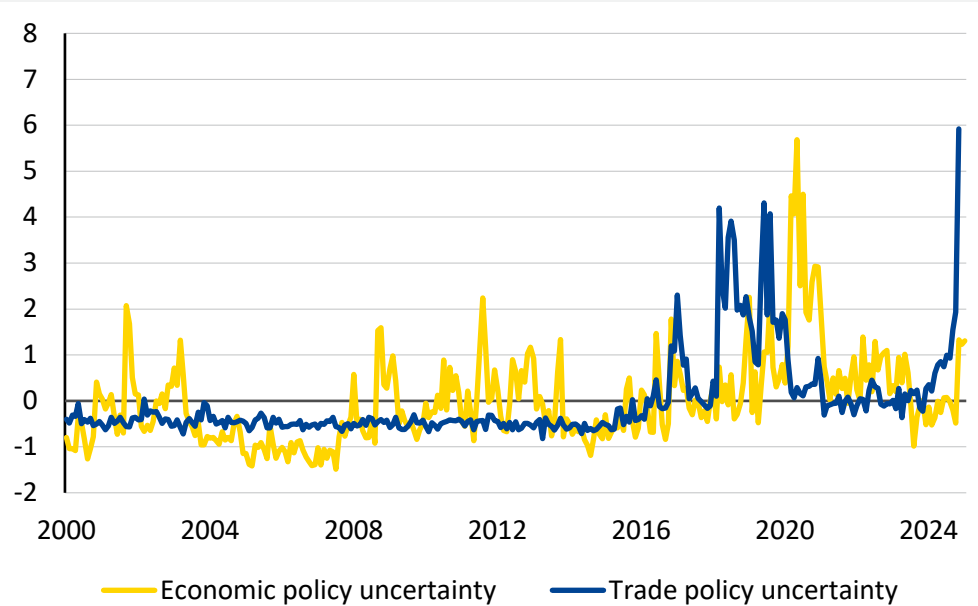
- Autumn Package includes Opinions on Draft Budgetary Plans (DBP)
- Spring Package includes the Assessment of compliance with Stability and Growth Pact (SGP)

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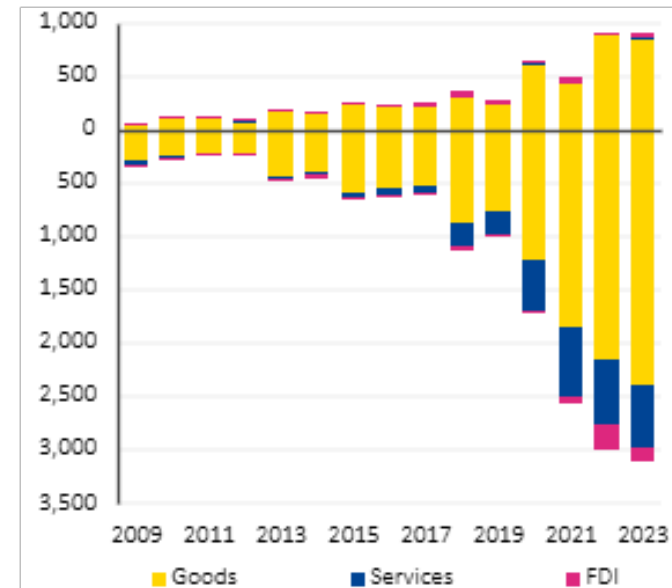
US UNCERTAINTY AND HARMFUL MEASURES FOSTER GEOECONOMIC FRAGMENTATION

US economic and trade policy uncertainty z-scores



Source: Baker, Bloom, Davis via Haver

Number of newly implemented trade and FDI measures

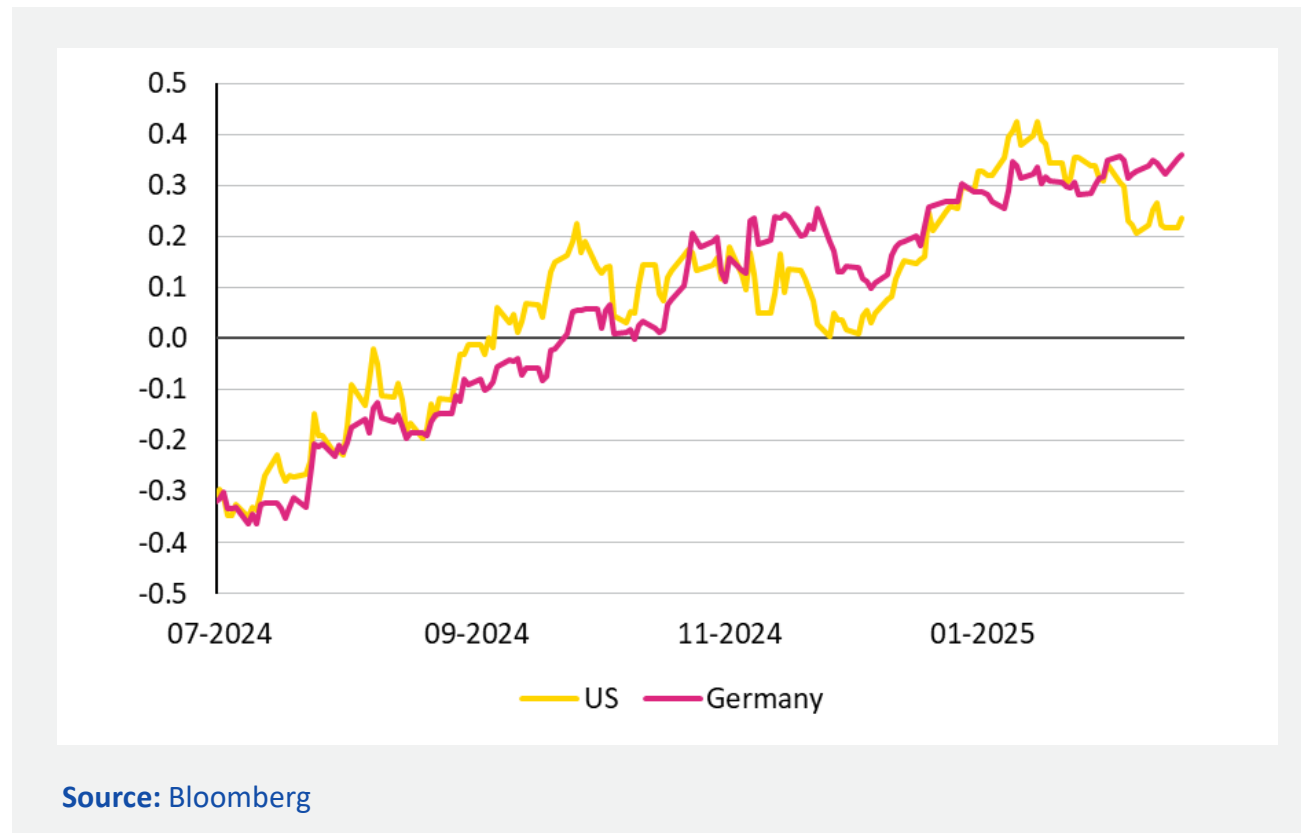


Source: Global Trade Alert

Note: The chart includes measures implemented by all government bodies (supranational, national, subnational) and by international and national financial institutions, at the global level. FDI: foreign direct investment.

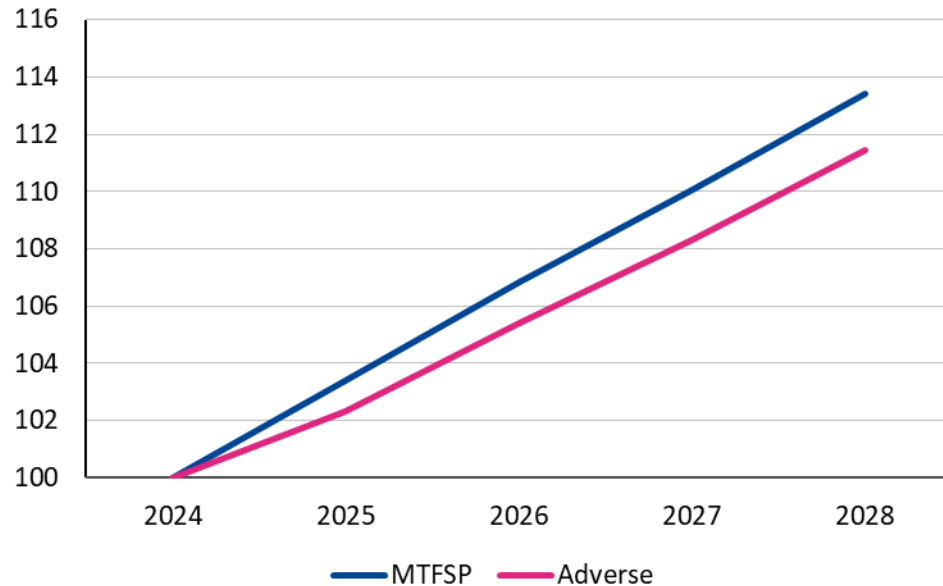
STEEPER US CURVE AFFECTS EUROPE

US and German yield curve steepness 10-year minus 2-year bond yields



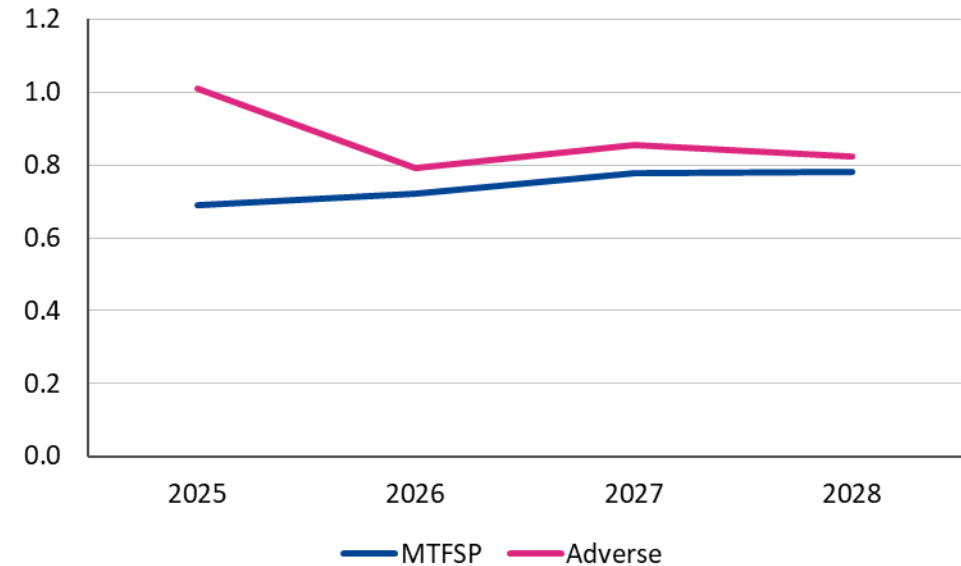
TRADE BARRIERS LOWER GROWTH, WHILE PUBLIC SPENDING REMAINS UNAFFECTED UNDER THE RULES

Euro area nominal GDP under MTSFP and US shock
(index 2024=100)



Tariffs reduce GDP because they increase cost and distort trade and investment.

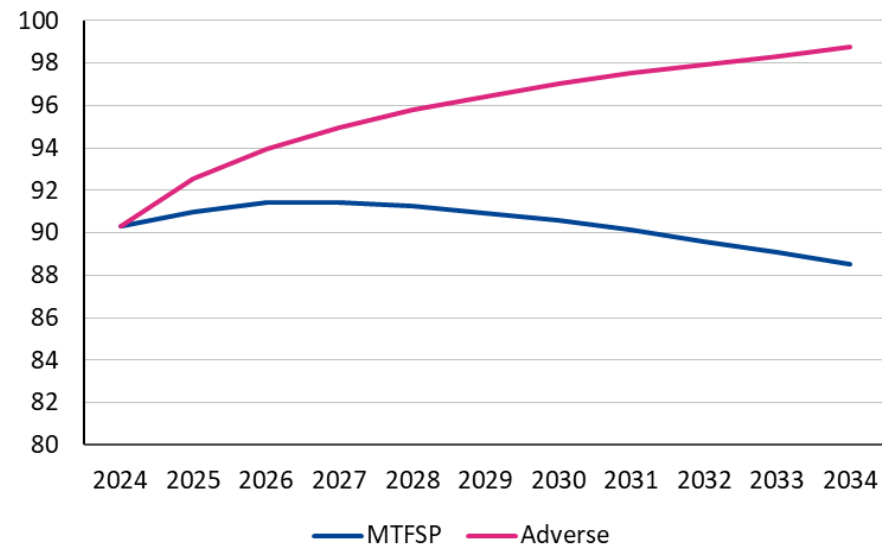
Ratio of net expenditure growth over nominal growth
(ratio)



Fixed net expenditure growth under the rules increases the weight of spending relative to GDP.

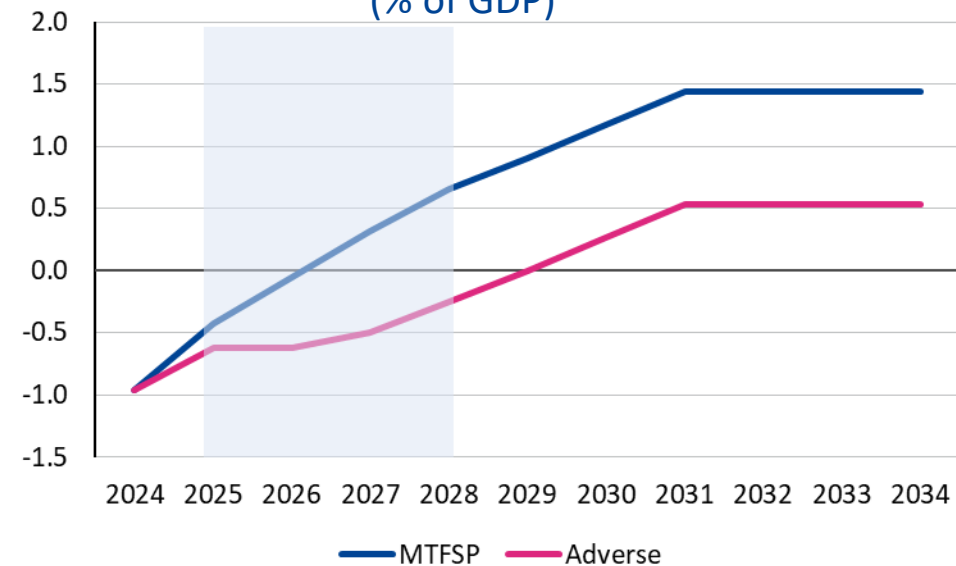
FLEXIBILITY ALLOWS TO RESPOND TO SHOCKS BUT POINTS AT LONGER AND HIGHER ADJUSTMENT

Euro area debt under MTSFP and US shock
(% of GDP and %)



With higher US tariffs, the Euro Area could experience **rising debt** despite compliance with rules.

Euro area structural primary balance under MTSFP and US shock
(% of GDP)



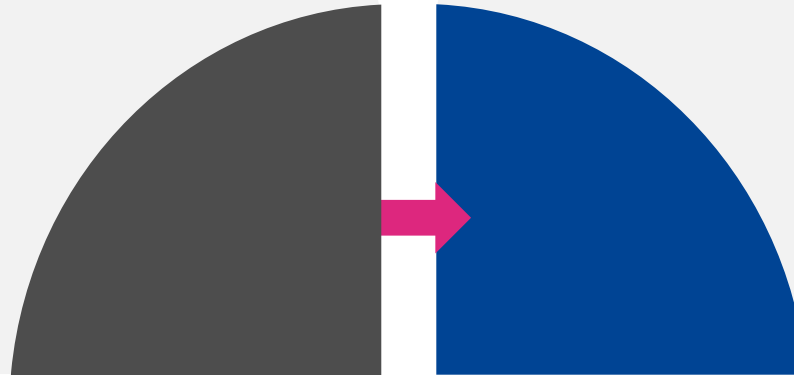
More time and/or additional adjustment is required to safeguard sustainability.

Source: ESM estimates

Note: Both scenarios assume compliance with the endorsed net expenditure growth paths, where available.

CAN THE NEW FISCAL FRAMEWORK HANDLE RISING GEOPOLITICAL UNCERTAINTY?

Flexibility of framework allows member states to respond to shocks BUT **weakens fiscal positions**.



- **Less fiscal space** to address long-term spending pressures
- **More time and/or additional adjustment** to safeguard sustainability
- **Implementation and re-evaluation** of adjustments (every 4 years) are key.

Long-term challenges—low potential growth, spending pressures (ageing) and eroding competitiveness—**main threats** to fiscal sustainability.



Structural reforms focused on productivity, efficiency, and innovation are essential to safeguard sustainability.





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