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EUROZONE

Don't lose sight of the consolidation target

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On the back of favorable conditions such as low interest rates and healthy economic growth, headway is being made in consolidating public-sector budgets in the eurozone. Nonetheless, the descent from the debt mountain will be long and drawn-out and it would therefore be a mistake to loosen the fiscal reins further on the basis of early successes. Our calculations show that, with the exception of Ireland, all former eurozone crisis countries will still not meet the Maastricht debt criterion in 15 years' time.

Broadly speaking, the development in government debt in the eurozone is moving in the right direction. In 2016 the public-sector deficit came in at 1.5% of economic output – the lowest figure since 2007 – having stood at 2.1% the year before.

Tailwind from economic recovery and low interest rates

However, the declining public-sector deficit cannot be attributed to a stringent consolidation policy, but stems primarily from healthy economic growth in the eurozone. Even though government spending as a percentage of GDP fell for the third consecutive year (to 47.7% in 2016 from 48.5% in 2015), in absolute terms spending has risen steadily since 2007 and in 2016 was around 20% up on its pre-crisis level. The European Central Bank's ultra-loose monetary policy is another key driver of falling government spending. Since the ECB announced that, within its mandate, it would do whatever it takes to save the euro, the overall interest burden in the eurozone has fallen sharply – from 2.9% in 2012 to 2.2% in 2016. By contrast, overall government revenue was unable to match

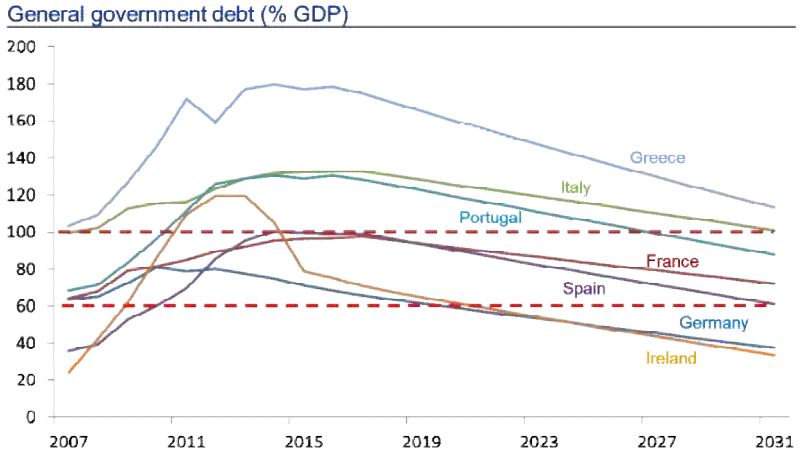
the pace of healthy economic growth and at 46.2% of GDP slipped marginally from the 46.4% recorded a year earlier.

Looked at by country, the trend in public finances still varies widely, although the gap is now smaller than it was just a few years ago. No fewer than eight eurozone countries were able to notch up a budget surplus in 2016, with Luxembourg leading the way with a surplus of 1.6%. By contrast, two member states still have a deficit of 3% or more, namely France with 3.4% and Spain with 4.5%.

Reduction in the debt mountain has only just begun

Despite the headway made in reining in public-sector deficits in the eurozone, the reduction in the debt mountains has barely begun. Although the government debt ratio fell for the second year running in 2016, at 89.2% of GDP the debt burden is still some 25 percentage points higher than it was before the crisis. In 2016 only six eurozone countries met the 60% Maastricht debt criterion. In five member states, by contrast, the debt ratio was still above the 100% mark, in some cases substantially.

Projections for the development of public debt in selected eurozone countries



Sources: Eurostat, own calculations and projections.

Don't lose sight of the consolidation targets

Our calculations for the development in government debt in the eurozone Big Three (Germany, France and Italy), and in the four former crisis countries (Spain, Portugal, Ireland and Greece) show that a sustained reduction in the respective debt mountains is likely to be slow and drawn-out. Over the next 15 years among these countries only Germany and Ireland will manage to meet the 60% debt criterion of the Stability and Growth Pact. Although Spain will only just miss the benchmark, both Greece and Italy are likely to still have debt ratios of more than 100% even in 2031. Despite the initial headway made in consolidating public-sector budgets, the aim now must be not to immediately loosen the fiscal reins again and not to lose sight of the consolidation targets. Precisely against the current favorable economic backdrop, the descent from the debt mountain is likely to proceed substantially more quickly and less painfully.

Our interactive Debt Tool allows you to simulate the development in the debt ratios of selected eurozone economies by applying various assumptions, and to compare the figures with our forecasts. You can find the tool here:

https://www.allianz.com/en/economic_research/research_data/debt-tool/

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