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BANCA PROMOS

The year to come

An overview of the draft budgets of Germany, France, Italy, Spain and the Netherlands

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Key upcoming dates (EU)

December 6
Rating review: Croatia (Fitch), Denmark (DBRS), Estonia (S&P), Germany (DBRS), Poland (DBRS), Sweden (Fitch)

December 12-13
European Council

December 13
Euro Summit

December 13
Rating review: France (Fitch), Slovenia (S&P), Spain (Fitch), United Kingdom (DBRS)

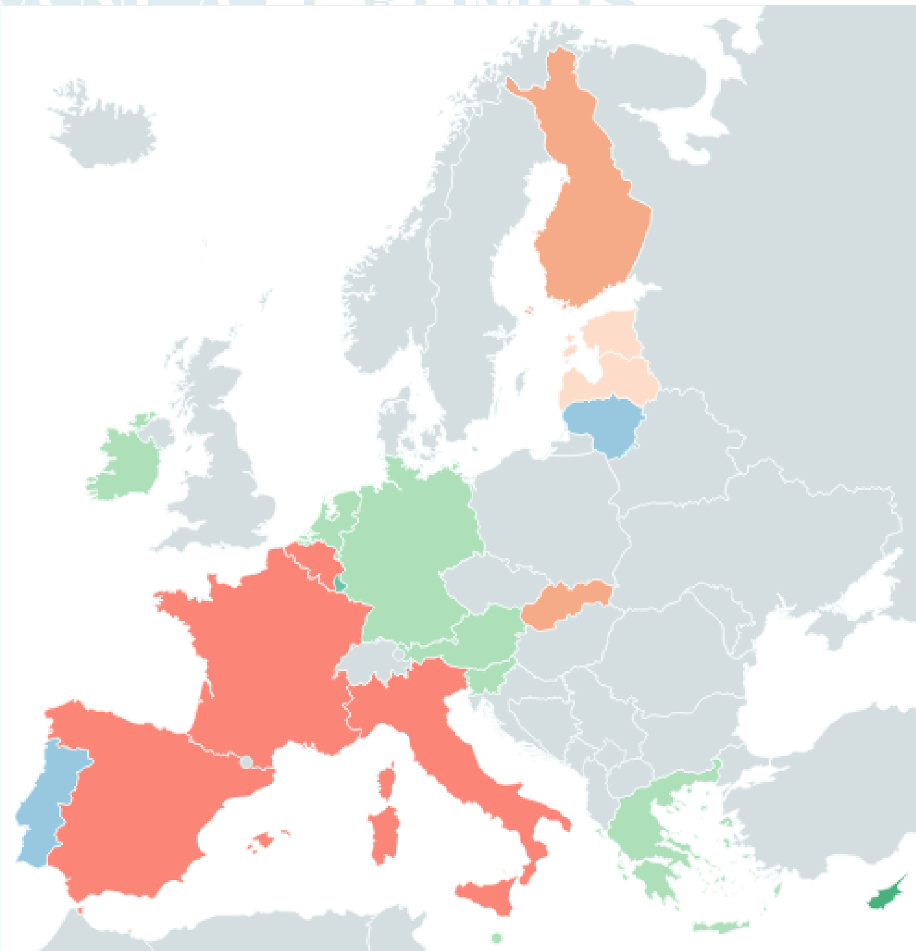
December 31
End of mandate: Benoît Cœuré

Persistent factors of **global uncertainty** (from trade wars to Brexit) combined with fears of decreasing effectiveness of (ECB's) **monetary policy** have brought the **fiscal stance** of European countries at the center of the economic debate. Calls to stimulate their economies in order to counteract their slowdown and its EU-wide spillovers, abound for governments in Germany and the Netherlands.

The **budget cycle** of EU countries will end on **December 31** and, as proven by Italy's political debate, spending and tax plans can still change, even significantly. Anyway, as for now, the analysis of the 2020 Draft Budgetary Plans of the five largest economies in the eurozone highlights a lack of **fiscal coordination** among governments: on the one hand, there are those who don't invest enough and on the other hand, those who don't show adequate efforts for consolidation.

Eurozone: Headline balance targets for 2020 (% of GDP)

Belgium	-2.3
Italy	-2.3
France	-2.2
Spain	-2.2
Finland	-1.4
Slovakia	-1.2
Latvia	-0.6
Estonia	-0.2
Lithuania	0.0
Portugal	0.0
Austria	0.2
Ireland	0.3
Netherlands	0.5
Slovenia	0.5
Germany	3/4
Greece	1.0
Malta	1.0
Luxembourg	1.4
Cyprus	2.6



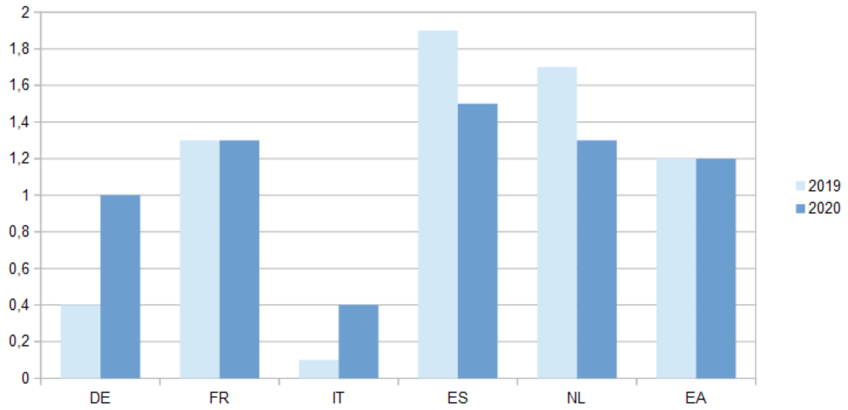
Source: European Commission, autumn forecast (Nov. 7, 2019)

Overall Assessment

On November 20, **the European Commission has presented its opinions on the 2020 Draft Budgetary Plans** (DBPs) **of the 19 countries of the euro area**.

The Overall Assessment of the Commission starts from the observation that **the European** (and global) **economy has weakened** over the last year. The slowdown in Europe, initially weighting on external demand and on the manufacturing sector, is now also extending to other sectors of the economy of the Old Continent. According to the Commission, **a meaningful rebound in European growth over the next two years is 'unlikely'.**

Real GDP growth (%)



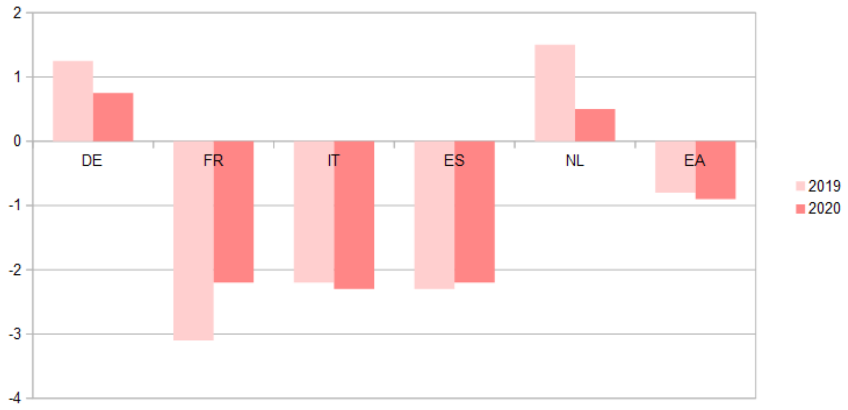
Note: DE (Germany), FR (France), IT (Italy), ES (Spain), NL (Netherlands), EA (Euro Area)

Source: European Commission, autumn forecast (Nov. 7, 2019)

Despite the rather gloomy outlook, the Brussel-based institution tries to see the glass half full, emphasizing that, **for the first time since 2002, no State in the euro area is involved in an Excessive Deficit Procedure** (EDP) and that, in 2019, only France will show a headline deficit exceeding 3% of Gross Domestic Product.

As for 2020, according to the Commission's autumn forecast, only **four countries will have a headline deficit above 2% of GDP** (Belgium: -2.3%, Italy: -2.3%, France: -2.2%, Spain: -2.2%), while **nine countries** (including Germany and the Netherlands) **will show a budget surplus** (+0.75% and +0.5%, respectively).

Headline balance targets (% of GDP)



Source: European Commission, autumn forecast (Nov. 7, 2019)

Overall compliance of DBPs with the SGP

Risk of non-compliance (8)

- Belgium
- Finland
- France
- Italy
- Portugal
- Slovakia
- Slovenia
- Spain

Broadly compliant (2)

- Estonia
- Latvia

Compliant (9)

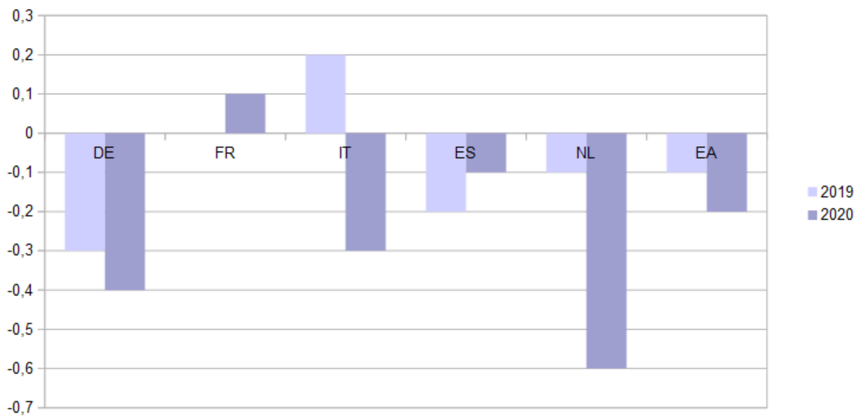
- Austria
- Cyprus
- Germany
- Greece
- Ireland
- Lithuania
- Luxembourg
- Malta
- Netherlands

Source: European Commission (Nov. 20, 2019)

Overall, **eurozone's headline deficit will increase** from 0.5% in 2018 to 0.8% in 2019, and then will reach 0.9% in 2020, in contrast with the downward trend of recent years.

As for the euro-area aggregate structural deficit (i.e. deficit adjusted for the cycle and net of one-off and temporary measures), **the Commission expects it to increase by 0.2%** of potential output **in 2020**, **which corresponds to a 'broadly neutral fiscal stance'.** The slight increase will be primarily driven by the expansionary policies of countries with fiscal space, such as Germany and the Netherlands, but also by the increase in Italy's structural deficit.

Changes in structural balance (pps. of potential GDP)



Source: European Commission, autumn forecast (Nov. 7, 2019)

Valdis Dombrovskis
Executive Vice-President of the European Commission

We need to take into account questions of fiscal sustainability, particularly in high debt countries, but we also need those countries that have the fiscal space to use it to stimulate the economy, especially to stimulate investment.

September 13, 2019

The Commission expects the euro-area debt-to-GDP ratio to continue its downward path of recent years, reaching 85% in 2020 (from 86% in 2019 and 88% in 2018), mainly thanks to the favorable low interest rate environment. The Commission highlights that these levels are well below those estimated for the United States (114%) and Japan (237%) in 2020. However, **France, Italy, Spain and Belgium will not meet their respective public debt reduction targets** in the two-year period 2019-2020.

Debt-to-GDP ratio (%)

Source: European Commission, autumn forecast (Nov. 7, 2019)

Pierre Moscovici
Former European Commissioner for Economic and Financial Affairs

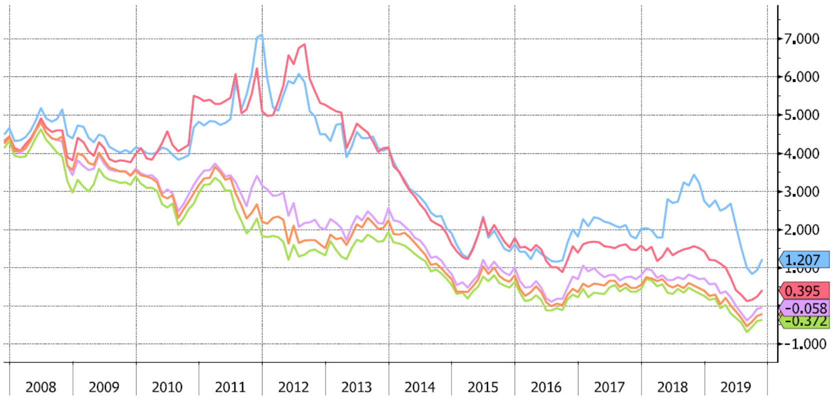
There are two kinds of countries: those who need to go further with their fiscal efforts and those who need to invest in growth.

October 9, 2019

In conclusion, according to the Commission, **the countries with larger fiscal space have implemented more expansionary fiscal policies**. In particular, Germany and the Netherlands have increased their investment spending in 2019 and have committed themselves to continuing the path of fiscal expansion also in 2020. **Nevertheless, their fiscal space remains partly unused**.

At the same time, **some member States with high levels of public debt have planned** for 2020 **either not to carry out any significant consolidation or to implement a fiscal expansion**, in contrast with the recommendation to rebuild their own budget buffers.

10Y sovereign bond yields (%)



Legend: France, Germany, Italy, Netherlands, Spain

Source: Bloomberg

The draft budgetary plans of eurozone's 5 largest economies

Germany

Germany's budget will show an expansive fiscal stance in 2020 as many of the measures included in the coalition agreement signed in March 2018 between CDU/CSU and SPD show their effects. According to the DBP, the structural surplus of the country will be reduced by 0.6% of GDP in 2020, mainly **due to measures aimed at reducing income taxation and increasing social benefits**, for the benefit of low- and middle-income earners.

Olaf Scholz
Minister of Finance
Germany

The main novelty of the draft budget presented by the government **is the Climate Action Programme 2030**, whose expansionary fiscal impact in 2020 should be around 0.1% of GDP. The program provides for the introduction of a CO_2 pricing system for sectors not covered by the European Union's Emission Trading System, together with programs aimed at encouraging environmentally friendly behaviors such as the reduction of railway ticket prices, subsidies for electric mobility and support for renewable energies.

Additional measures listed in the DBP **include**:

- **Support to families** by improving childcare facilities and increasing social benefits and tax reliefs;
- Increase in **investment grants for transports**, rural areas, **structurally weak regions** and local authorities;
- Additional funds to support economic change in former coal minig areas, a reform of the competition framework to attract more private investments, tax credits for companies involved in research and development, definition of **strategies for digitization**, blockchain and artificial intelligence.

France

Most of the measures included in France's DBP **were announced** by President Emmanuel Macron at the end of April, as an outcome of the Grand Débat launched in the country **in response to the yellow vests movement.**

Bruno Le Maire
Minister of Economy and Finance
France

On the revenue side, **the main measure in the draft budget is the permanent reduction of the personal income tax**, as of January 1, 2020. The cut, **targeting middle-income earners** and with a budgetary impact of €5bn (0.2% of GDP), will be achieved through a reduction in the marginal rate applied to the lowest tax bracket.

The resulting **reduction in tax revenues will be partly balanced by** other measures, including **the smoothing of the cut of the corporate income tax for large companies** (€0.8bn) and the suppression of the tax expenditure on the use of off-road diesel (€0.2bn).

On the expenditure side, the DBP provides for the cancellation of the under-indexation of lower pensions (under €2,000 per month) and **the increase in minimum pensions**, for a total cost of €1.5bn (0.1% of GDP) .

Finally, in January 2020, the reform of the reference income for allocation of housing benefits is expected to be implemented, bringing expenditure savings for about €1.4bn.

Italy

Roberto Gualtieri
Minister of Economy and Finance
Italy

According to the forecasts of Italy's government, the measures included in the DBP will increase the country's deficit by 0.9% of GDP in 2020.

The repeal of a VAT-increasing safeguard clause is the main measure envisaged in the draft budget, with a value equal to 1.3% of GDP. Net of this intervention, the initiatives presented by the government would reduce Italy's deficit by 0.4% of GDP.

On the revenue side -- and **excluding the VAT intervention** -- **the main deficit-increasing measure is the introduction of a fund to reduce the tax wedge on labor** (worth 0.2% of GDP).

On the expenditure side, two additional funds for the realization of public investments at national and local level are introduced, and expenses for the refinancing of so-called 'unchanged policies' (including military missions abroad) are confirmed.

Measures aimed at reducing deficit include:

- Higher taxes on gambling (below 0.1% of GDP);
- **The reduction of tax advantages for the most polluting company cars and the introduction of a new tax on plastic packages** (0.1% of GDP);
- The postponement of the deductibility of specific costs and budgetary losses for some categories of companies, in particular banks (0.1% of GDP);
- **Measures against tax fraud** (0.2% of GDP), including disincentives to the undue compensation of tax credits, the shift to the main contractor of the subcontractors' tax liabilities ('reverse charge') and measures against fraud in the fuel sector.

Finally, Italy's DBP mentions various measures to encourage electronic payments (including an ad hoc fund worth 0.2% of GDP) and a spending review to be conducted at the ministerial level (0.1% of GDP).

Spain

Nadia Calviño
Minister of Economy, Industry and Competitiveness
Spain

Spain is one of the four countries of the eurozone **that have presented** to the European Commission **a no-policy change plan**, either because they were involved in national elections between the end of September and mid-November (Austria, Portugal, Spain) or because involved in the process of forming a new government (Belgium).

Accordingly, Spain's DBP for 2020 is mostly built on measures already contained in the 2019 Stability Program.

The draft budget includes new expenditure measures worth between €4.7bn and €7bn (equal to 0.4%-0.5% of GDP) divided into:

- **Salary increase for public sector employees,** pursuant to the 2018-2020 trade union agreement;

- **Full pension indexation** based on the consumer price index at 0.9%.

DBP's projections also include cost savings deriving from the implementation of **recommendations from three different spending reviews** commissioned in 2018-2019 to AIReF (Autoridad Independiente de Responsabilidad Fiscal), in areas such as social transfers on prescription drugs and hiring incentives.

Netherlands

Wopke Hoekstra
Minister of Finance
Netherlands

Most of the discretionary measures envisaged by the Dutch government for 2020 are from the 2018-2021 government agreement and were therefore already included in the 2019 Stability Program.

For 2020, **the main budgetary measure is a substantial** further **lowering of labour income taxes** for households, with an estimated impact of 0.4% of GDP.

The DBP includes provisions on the labor market, including a temporary break in the increase of the retirement age and measures to facilitate longer working careers (incremental impact of around 0.05% of GDP).

The higher expenses related to the climate agreement will have a limited impact in 2020. Measures regarding housing and youth services will be more significant.

Finally, **the draft budget mentions the intention to create an investment fund to strenghten the Dutch economy**, without however providing details about its features.

Balanced approach

Gita Gopinath
IMF Chief Economist

A country like Germany should take advantage of negative borrowing rates to invest in social and infrastructure capital, even from a pure cost-benefit perspective.

October 15, 2019

The European Commission has judged the DBPs of Germany and the Netherlands as compliant with the provisions of the Stability and Growth Pact (SGP).

However, given their favorable budgetary situation, **the Commission has invited the governments of the two countries to undertake additional spending**.

In particular, Germany should achieve a sustained growth trend in public and private investments (particularly at regional and municipal level) and focus investment policies on education, research and innovation, digitalization, broadband, sustainable transport and affordable housing, taking into account the regional disparities existing in the country.

The Netherlands too should support an upward trend in investments and spend on research and development (particularly in the private sector), renewable energy, energy efficiency, strategies to reduce greenhouse gas emissions and in the management of transport bottlenecks.

As for France, Italy and Spain, instead, **the Commission is of the opinion that their DBPs are at risk of non-compliance with the provisions of the SGP**.

According to the Brussel-based institution, the governments of **Paris, Rome and Madrid have not taken advantage of the low level of interest rates** to reduce their pile of public debt and, in particular, the short-term sustainability of Italian public finances appears vulnerable to increases in the cost of debt issuance.

Eurogroup, December 4

In its last meeting of the year, **the Eurogroup has taken note of the assessment released** on November 20 **by the European Commission** on the DBPs of euro-area States and has issued a statement that broadly mirrors its contents.

According to the 19 Finance ministers, the euro area's growth outlook, while remaining positive, has weakened during 2019, and **the eurozone's economy is facing an elevated level of uncertainty.**

The Eurogroup highlights that the budgetary situations of member States are very different from each other and that, consequently, **should downside risks materialise, fiscal responses should be differentiated**, within a framework of mutual coordination.

According to the statement, it is worrying that the **countries that should rebuild their fiscal buffers are instead expected to implement measures of fiscal expansion** or still limited structural fiscal adjustments, with the consequence that their pace of debt reduction is still too slow.

The opinion about the countries that have made and will make use of their favorable budgetary situation is positive. **It is important**, the Eurogroup says, **for public finances across the euro area to show a growth-friendly composition,** giving a stronger emphasis to reforms and investments in research and development, in digitalization and on climate action.

FOCUS: “A green light for public investment”

The eurozone faces immense economic challenges, and **Germany and the Netherlands should take the lead** in tackling them.

This sentence effectively summarizes the content of the commentary published on Project Syndicate by **the leaders of the German and Dutch Green parties**, Robert Habeck and Jesse Klaver, on November 20, the same day the European Commission has announced its opinion on the draft budgets of eurozone countries.

According to the two authors, **what Europe needs is a large-scale**, possibly coordinated, **fiscal-stimulus package**, designed thinking about the future of the continent, thus focusing on the issues of climate change and technological development.

Although the economic conditions for this program are extremely favorable at the moment -- as **both Germany and the Netherlands** have ample fiscal space and **can borrow at negative interest rates** -- the political conditions are less so.

Habeck and Klaver believe that their countries' decision to keep their budgets in surplus, while asking their European partners too to comply with strict fiscal rules, is not in the EU's long-term interest: **for future generations**, **inheriting a low debt-to-GDP ratio makes little sense if on the other hand they will inherit outdated economies and a climate crisis**.

The fiscal framework of the European Union is not wrong in principle, but it is misguided if it focuses exclusively on the liabilities of member States (public debt), ignoring their assets (public investments).

So, here it is the proposal of the two political leaders: **reforming European rules** to further differentiate the treatment of current spending from investment spending, **allowing governments** -- as it already happens with private companies -- **to distribute capital expenditures over their full maturity period**.

It is time for Germany and the Netherlands to react to the 'green light' by committing to investments in innovation, education and sustainability.

Alliance 90 / The Greens (DE)

Bundestag: 67 / 709

Bundesrat: 12 / 69

European Parliament: 21 / 96

BÜNDNIS 90 DIE GRÜNEN

Source: Wikipedia

GroenLinks (NL)

Second Chamber: 14 / 150

First Chamber: 8 / 75

European Parliament: 3 / 26

GROEN LINKS

Source: Wikipedia

Conclusions

Just a few weeks until the end of 2019, and it is by now clear that the year has passed without any of the great global concerns with which it started having come to an end. Indeed, **the trade war** between the United States and China, **and Brexit negotiations continue to weigh on** European and international **growth prospects**.

Therefore, **it is not surprising that**, month after month, **the chorus of those urging a reaction** from European countries with greater fiscal space **has become increasingly loud**. A list, the latter, which includes, incidentally, some of the economies most exposed to international risk factors, such as Germany, the Netherlands and Ireland.

A few days before taking office as President of the ECB, **Christine Lagarde** -- with a past as head of France's public finances in the years of the crisis (from 2007 to 2011) -- **has explicitly mentioned Germany and the Netherlands among the countries that should do more** in terms of budgetary measures to stimulate growth and inflation in the euro area.

Christine Lagarde
ECB President

Those that have the room for manoeuvre, those that have a budget surplus, that's to say Germany, the Netherlands, why not use that budget surplus and invest in infrastructure? Why not invest in education? Why not invest in innovation, to allow for a better rebalancing?

October 30, 2019

A point of view that is fully aligned with that of her predecessor, Mario Draghi, who said that "**monetary policy can still achieve its objective, but it can do so faster** and with fewer side effects **if fiscal policies are aligned with it**."

Germany, the EU's leading economy, with a manufacturing sector heavily dependent on exports, **has had to glimpse the threat of a technical recession** -- avoided only thanks to a modest (one could say Italian) +0.1% of GDP growth in the third quarter of the year -- **to decide to soften**, even if only slightly, **its fiscal stance** for 2020.

The whole country is facing a trade off between the widespread aversion to the policy of negative interest rates and the likewise popular opposition to budget deficits. From the point of view of Angela Merkel's government, **using Germany's fiscal space in full could accelerate the end of the ultra-expansive policies of the European Central Bank, but it would mean giving up the totem of the Black Zero** (Schwarze Null). Conversely, remaining committed to a policy of budgetary rigor is equivalent to prolonging the discontent of the banks and savers (read 'electors') of the country.

In this scenario, **the victory of the candidates of the left wing of the SPD**, Norbert Walter-Borjans (former Minister of Finance of North Rhine-Westphalia) and Saskia Esken (lawmaker in the Bundestag), against the tandem led by the the current German Finance minister Olaf Scholz, **in the race for the leadership of the Social Democratic Party could prove to be a turning point**.

The bear steepening of Germany's sovereign curve on the first day of trading after the elections has immediately reflected two possible scenarios (of which the first is more likely than the second). **On the one hand, the expectation of a potential easing of budgetary rigor**, driven by pressures this time coming form within the very executive. **On the other hand**, if such requests will be considered unacceptable by the majority shareholder of the governing coalition, **the fear of an interruption of the alliance with the CDU/CSU**, which would open the doors to either a minority government or early elections.