Box I.2.3: **A forecast that is tailored to, and evolves with, the needs of macroeconomic surveillance**

Independent economic and budgetary forecasts are an anchor of good policy-making and effective macroeconomic surveillance. The Commission's European Economic Forecasts are independently prepared by Commission staff, and have been the starting point for policy procedures for many years. Economic forecasts aim at providing a diagnosis of economic developments in each of the Member States and in the European Union.

The Commission's European Economic Forecasts will continue to underpin the reformed macroeconomic governance in the EU. After constructive negotiations among the co-legislators and the Commission, the new economic governance framework for the European Union has recently entered into force [(1)]. The objectives of the reformed framework are public debt sustainability, and sustainable and inclusive growth through reforms and investments. The new framework enhances national ownership, and has a greater medium-term focus, combined with a more effective and coherent enforcement. Against this background, this box describes some new features related to the new economic governance framework, recalls some well-established characteristics of the Commission's forecasts, and comments on other recent developments.

Commission's budgetary forecasts at the centre of fiscal surveillance

Under the new governance, Member States' fiscal commitments will be operationalised through net expenditure paths. A central novelty of the reformed framework is that Member States will submit by this autumn their first medium-term fiscal-structural plans. In these plans, Member States commit to expenditure paths, i.e. to nominal growth rates of *net nationally financed primary expenditure* that bring their debt onto a sustainable path [(2)]. Net nationally financed primary expenditure (or simply 'net primary expenditure') is government expenditure excluding interest expenditure and expenditure matched by revenue from EU funds, and net of the fiscal impact of revenue measures [(3)].

This Spring Forecast provides essential input for Member States' new medium-term plans. As the initial step for the preparation of their plans, the Commission provides to Member States with deficit or debt ratios above the thresholds of 3% and 60% of GDP reference expenditure trajectories. These trajectories, which are based on the debt sustainability situation in each country, are then considered by the Members States for the formulation of their medium-term plans. The fiscal requirement from the reference trajectory is driven by the expected potential growth and the initial position in terms of structural primary balance – both have been and will continue to be estimated by the Commission in the context of its macroeconomic forecasts – as well as by expected developments

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(1) The legal acts that reformed the economic governance and entered into force on 30 April 2024 are (a) Regulation (EU) 2024/1263 of the Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance; (b) Council Regulation (EU) 2024/1264 (which amended Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure), and (c) Council Directive (EU) 2024/1265 (which amended Directive 2011/85/EU on requirements for budgetary frameworks of the Member States).

(2) The path also ensures compliance with a number of numerical safeguards, e.g. to ensure a minimum annual decrease in the debt-to-GDP ratio for Member States where the debt-to-GPD ratio exceeds 60%, or to ensure a resilience margin in structural terms of 1.5% of GDP compared to the 3%-of-GDP reference value.

(3) Expenditure matched by revenue from EU funds (such as investments financed with grants from the Recovery and Resilience Facility) are excluded because such expenditure has no impact on the general government deficit or the debt sustainability. Discretionary revenue measures (such as tax cuts or increases) are taken into account as these may reinforce or offset the fiscal adjustment from expenditure increases. The indicator further excludes the cyclical component of unemployment benefits, as well as the impact of one-off measures (revenue as well as expenditure) in view of their transient impact on government finances, as well as national expenditure on co-financing of programmes funded by the Union.

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Box (continued)

in the implicit interest rates on the government debt and the expected demographic-related costs [4]. Experience shows that, among these variables the structural primary balance for the ongoing year is of crucial relevance. This means that, although the structural (primary) balance will lose the relevance that it had under the previous set of rules in the in-year monitoring of fiscal policy, it will remain central as a starting point to define the Member States' fiscal commitments.

From now on, net primary expenditure will be the cornerstone of the new surveillance framework. The Commission will project developments for each of the components of net primary expenditure. As from the next forecast, projections for the net primary expenditure growth will be added to the usual tables and fiscal variables, which already include government deficit, debt, cyclically-adjusted deficit and structural (primary) balance.

Interpretation of the Commission's budgetary forecasts

The Commission's forecasts will continue to be based on the no-policy-change assumption. The Commission's forecasts assume a continuation of existing budgetary policies [5]. This is commonly referred to as the *no-policy-change assumption*. This means that the forecast does not incorporate a reaction function for the general government, or fiscal closure rule, even in cases where such a reaction is very likely (e.g. for countries with binding policy targets, even when these are constitutionally mandated, or in case of measures on which a political consensus is building, but which have not yet lead to a government decision). Also, the forecast does not make assumptions on policy choices still to be taken. For example, a government may announce its intentions to correct an excessive deficit or to better control net expenditure, and while this intention may be fully credible, it will only be reflected in the Commission forecast after the government has decided which revenue or expenditure measures it will concretely take to achieve this policy action. In the context of the new framework based on expenditure paths, the Commission forecasts will serve to identify the size of the additional policy action that is necessary to abide by the net expenditure growth rate each Member State has committed to in their medium-term plans.

A good and useful budgetary forecast is the one that leads to actions that will ultimately refute the forecast. The main objective of producing a budgetary forecast is to identify gaps between current policies and fiscal objectives. In other words, it provides information on the size of policy action needed to achieve the budgetary targets. This is used to guide the Commission's assessment of Member State's national budgets and to inform policy action. If the budgetary forecast triggers a policy response from the Member State to close the gap between forecast and target, the forecast fulfils its main purpose. Thus, paradoxically a good and useful budgetary forecast is the one that leads to actions that will ultimately refute the forecast, given that its projections will no longer stand when corrective actions are taken. For this reason, criticism noting that the Commission forecast systematically overestimates fiscal deficits in countries that traditionally adopt large corrective measures during the fiscal year may be misguided.

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(4) On the latter, the Commission has regularly published in cooperation with the Economic Policy Committee the Ageing Report: the last edition (April 2024) was been published in the European Economy-Institutional Papers, 279. The Ageing Report includes comprehensive long-term budgetary projections until 2070 based on the latest population projections by Eurostat. It provides insights into the timing of population ageing, its economic implications and on how ageing-related costs might develop in the future, considering the latest information and legislated reforms.

(5) In practice including the measures that have been credibly announced and sufficiently detailed at the cut-off date of the forecast.