

CHAPTER 1: EU MACROECONOMIC DYNAMICS - TRENDS, POLICIES AND PROPOSALS FOR ALTERNATIVES

In this chapter, we look into the state of the EU economy in terms of the main macroeconomic trends of the past year, the fiscal and monetary policies pursued and their implications. The chapter ends with alternative proposals in a radical, progressive direction.

1.1. Macroeconomic trends – Stagnation lingers on

Following two years of near stagnation, the EU economy **grew** by 1.4% (Eurozone, 1.3%) in 2025 (European Commission, 2025a). However, as shown in Table 1, three of the largest European economies –Germany, France and Italy– were still stagnating, while very low growth rates were recorded both among the Nordic countries (Finland) and among the CEEs (Estonia, Hungary, Romania)¹. The exceptionally high growth rate of Ireland reflects a country-specific factor, namely its large multinational sector.

According to a Eurostat preliminary flash estimate for the fourth quarter (Q4) of 2025, the rate of growth of GDP was slightly higher, at 1.6% for the EU (Eurozone, 1.5%). The overall picture of lingering stagnation across the EU is not however altered (Eurostat, 2026).

The **increase in GDP** was largely the result of the beneficial effect of the NextGenEU programme, put in place following the Covid-19 health crisis in 2020. This boosted both private and public consumption, which increased by 1.5% (EZ, 1.3%) and 1.8% (EZ, 1.8%) respectively.

Investment also received a boost from the NGEU programme. In particular, total investment rose by 2.0% (EZ, 2.2%) overcoming the decline of 2024, while public investment increased by 3.8% (EZ, 3.6%). As the NGEU programme is due to expire in 2026, not to be succeeded by a plan of a similar social and economic ambition, investment in the EU will likely return to its previous sluggish state. Increased rearmament and defence spending may increase the rate of investment, although it is unlikely to serve the wider needs of climate change and social cohesion.

Inflation, (%), measured in terms of the Harmonised Index of Consumer Prices (HICP), remained stable at close to 2% both for the EU average of 2.5% (Eurozone, 2.1, and in most member states, with some exceptions in Central and Eastern Europe.

¹ Although GDP is a poor indicator, much less measure, of economic activity, its widespread use renders it difficult to avoid it.

Furthermore, excluding energy, food, alcohol and tobacco from the HICP makes very little difference to the overall index (EU, 2.6% - EZ, 2.4%)². The downward trend of inflation appears to continue in early 2026, although the available data is incomplete and subject to revisions. On the other hand, the war between US-Israel and Iran that erupted in early March initially led to a steep increase in energy prices, which will feed into the rate of inflation. The longer this war lasts, the greater the effect on inflation and on the economy more generally.

House prices have been increasing steadily across the EU member states. This is not reflected in the HICP, which includes rentals but not house prices or mortgage payments, or indeed the implicit rent of owner-occupied housing. Thus, in the third quarter (Q3) of 2025, house prices, as measured by the House Price Index, increased by 5.5% in the EU (Eurozone, 5.1%) compared with the same quarter of the previous year. Such developments need to be taken into account in considering the living standards and costs of households in the EU.

Real compensation of employees per head was equal to 47.9% of GDP in the EU (EZ, 48.6%) in 2024 (Eurostat, 2025b). It consisted of wages and salaries (EU - EZ, 38.2%) and employers' social contributions (EU, 9.7% - EZ, 10.4%). It is worth noting that thirteen EU countries recorded a share of GDP that was below the EU average for compensation of employees, with the lowest proportions in Ireland (28.5%), Greece (35%) and Italy (39.5%). Gross operating surplus, on the other hand, was equal to 40.9% of GDP (EZ, 40.7), while it was highest in Ireland (64.8%), Malta (51.9%) and Greece (50.2%).

Over the 20-year period 2004-2024, the share of employees' compensation increased mainly during the global financial crisis and the Covid-19 health crisis. Overall, the net gain for labour between 2004 and 2024 was a mere 1.3%, limiting the role of wages as a demand factor and underlining the unequal distribution of income between labour and capital.

Unemployment remained constant at 5.9% of the labour force (EZ, 6.3%), although there is considerable variation across the EU member states, with the highest rates recorded in Spain (10.4%) and in Greece (9.3%)³. Further, the unemployment rate for the under 25's was significantly higher than the average. This reached 14.8% in the EU (EZ, 14.4%), while the highest rates were recorded in Spain (25%), Sweden (24%) and Finland (21.5%).

² The transitory nature of the inflation rate of the early 2020s has thus vindicated those who argued against the steep rise in interest rates by the ECB, including the EuroMemo Group.

³ The unemployment rate for women was close to the average for the labour force, at 6.1% (EZ, 6.5%).

In 2025, the **fiscal profile** of the EU economy included a relatively low public deficit in relation to GDP, at 3.3% (EZ, 3.2%) and a high public debt/GDP ratio, at 82.8% (EZ, 88.8) by comparison to the reference values of 3% and 60% respectively, set by the Stability and Growth Pact, which was reinstated in 2024. There was great variation across the member states in terms of both the public deficit and the public debt ratios. In fact, nine member states are under an ongoing Excessive Deficit Procedure (EDP), which may eventually result in fines should corrective measures not be taken by their governments. These are Austria, Belgium, France, Hungary, Italy, Malta, Poland, Romania and Slovakia, accounting for 47% of the total EU economy, in terms of GDP, at current prices (Eurostat, prc_ppp_ind). In addition, the Commission is considering proposing the opening of an EDP for Finland, bringing the share of the 'errant' countries to 48% of EU GDP. Thus, the fiscal straightjacket of the SGP is on again, after a 4-year break (2021-2024) during which it was suspended, choking the EU economy anew.

The combination of domestic and global trends is reflected in the **Current Account balance**⁴. The EU has traditionally had a surplus with the rest of the world. In 2025, this stood at 2.5% of GDP (EZ, 2.7%), lower than in 2024 (EU, 3.2% and EZ, 3.3%). Disaggregating the average figure by country reveals a significant variation across the EU. In particular, 12 member states – mostly CEEs - had a deficit. By contrast, Denmark had the highest current account surplus (12%), followed by the Netherlands (9.1%), Malta (5.1%), Sweden (4.4%) and Germany (4.8%). Ireland's high surplus (9.7%) is due to its multinational sector. Overall, the export-led growth model mostly applies to the Nordic countries and to certain Western European countries. In particular, two countries - Germany and the Netherlands - accounted for 67% of the EU's total current account surplus in 2025. In absolute figures, the surplus of Germany amounted to €214.1 billion and that of the Netherlands to €107.5 billion, while that of the EU was equal to €476.8 billion.

The **share of the EU in world trade** (goods and services) reached 15.8% in 2024, placing it above the USA (13.6%), China (13.6%) and the UK (4.2%) (European Council, 2025). Its top export partners include the USA (20.6%), UK (13.2%) and China (8.3%), while its main import partners are China (21.3%), USA (13.7%) and UK (6.7%). In view of the role of the EU in global trade, any shift in trading relations through new agreements and/or changing geopolitical conditions have wider repercussions.

In 2025, a new **trade agreement** was signed between the EU and the USA. Its main elements include the elimination of EU tariffs on all US industrial goods,

⁴ This is the sum of trade in goods and services, net income, and current transfers with other countries

preferential market access for a wide range of US seafood and agricultural goods, a maximum 15% US tariff for EU goods and a tariff rate quota for steel & aluminium. Further, the EU is to buy US energy products valued at \$750 billion and to invest \$600 billion in the US by 2028, as well as to 'substantially increase' its procurement of military and defence equipment from US and to address 'undue restrictions on transatlantic trade' and 'unjustified digital trade barriers'.

The Agreement needs to be approved by the European Parliament. However, following President Trump's threats to use tariffs by way of leverage over Greenland, the EP put the implementation of trade plans on hold 'until the US decides to re-engage on a path of cooperation rather than confrontation and before any further steps are taken', as Bernd Lange, chair of the EP's International Trade Committee put it (BBC, 2026).

Overall, the US-EU Trade Agreement is asymmetrical in favour of the former. As such it will adversely affect the EU economy and especially those countries that have traditionally relied on an export-led model of growth, such as Germany.

More generally, the use of tariffs and other restrictions by the Trump administration is effectively reshaping trade relations on a global scale. As its reliance on trade with the US is weakened, the EU is seeking new trade agreements, such as with India, Indonesia and Cuba, or finalising agreements that have been under discussion for a long time, such as Mercosur. Although such a reaction is to be expected, it runs the risk of creating domestic social and economic tensions, such as those by EU farmers in the case of the Mercosur agreement. Thus what borders on trade war by the US may well lead to internal upheaval within the EU.

1.2. Policies – The implications of militarisation

The 2024 revision of the EU's fiscal policy surveillance framework did not change its basic precept, namely that austerity is the way forward for the EU economy. As Paul de Grauwe has argued:

Fiscal policies in Eurozone countries have long been shaped by the Stability and Growth Pact (SGP). This framework was conceived as a means to enforce orthodox fiscal rules designed to steer member states towards balanced budgets. Although the SGP was temporarily suspended during the pandemic, it was reintroduced in 2024 with minor, largely superficial, revisions The core principles of the SGP therefore remain unchanged. (De Grauwe, 2025)

As already mentioned above, the Excessive Deficit Procedure, which under the new SGP version also encompasses public debt, has been opened for nine member

states and it is about to be opened for one more. The EDP compels governments to implement austerity measures in order to comply with the SGP rules. Furthermore, the 'war economy mode' the European Commission has introduced as part of its militarisation agenda, is in effect a fiscal trap for the EU member states, apart from its broader implications for the economy and society (Frangakis, 2025). This is especially the case in relation to member states with a high public debt and/or a low military expenditure.

More specifically, on 19/3/2025 the European Commission presented its White Paper for 'European Defence. Readiness 2030', which aims at mobilizing 800 billion euros (\$870 billion) over four years, through the following means (European Commission, 2025b).

- Activating the national escape clause of the SGP, which allows increased spending by a member state in the event of "exceptional circumstances outside the control of the member state with a major impact on its public finances, provided that it does not endanger fiscal sustainability over the medium term" (Art. 25, Reg. (EU) 2024/1263).
- Exempting increased spending on defence by up to 1.5% of GDP from the annual spending limits for four years, starting in 2025. After that time, national budgets will need to be adjusted, so as to comply with the SGP deficit and debt rules. The Commission estimates that an amount of 650 billion Euro will be raised.
- Contracting new joint EU borrowing, amounting to 150 billion Euro, against the security of the EU budget, to provide loans to member states. It is worth noting that joint borrowing on a far larger scale was part of the EU's response to the pandemic crisis. The proceeds were passed on to member states by way of loans and transfers approximately in equal measure. The Readiness 2030 plan contains no transfers.
- Leveraging on the European Investment Bank, which has AAA rating on the market.
- Launching a fresh push to integrate the EU's capital markets. The so-called Savings and Investment Union (SIU) aims at tapping the savings accounts in banks.

In view of the significant divergences across the EU member states, the Readiness 2030 plan will undermine social cohesion to the extent that funds are diverted towards military purposes, away from other uses, although increased public spending may indeed add jobs to the EU economy, depending on how much of that spending goes to imports from outside the EU.

In particular, the new ‘consensus’ amongst governments, markets and military contractors, whereby military spending is supposed to contribute to sustainability, threatens to rewrite the rules of public spending and financial regulation. As pointed out by Vandeloise and Van Wynsberghe (2025) “trying to rebrand defence as ‘sustainable’ risks breaking the objectives the rules are meant to achieve and further undermining sustainable finance”.

Furthermore, it will burden highly indebted countries as the leniency accorded to defence spending is temporary. In addition, the commitment of NATO members - 23 of which are also members of the EU - to raise their defence spending to 5% of GDP per year by 2035 will increase the fiscal burden.⁵ Indeed, the IMF is already posing the question ‘How can Europe pay for things that it can’t afford?’ concluding that austerity both in the short and in the long run is the answer:

Without stronger growth and fiscal consolidation, average European debt could reach 130 percent of GDP by 2040, requiring significant fiscal adjustment. Near-term policies should maintain price stability, start fiscal consolidation, and keep trade open (IMF, 2025).

On the monetary front, the ECB started cutting its benchmark interest rate in June 2024, continuing throughout 2024 until June 2025. It has kept all key interest rates unchanged at its subsequent meetings in 2025 and in early 2026. Overall, the main refinancing operations rate declined from 4.5% in June 2024 to 2.15% in June 2025⁶. Thus, borrowing costs are at their lowest level since December 2022.

The current monetary policy stance follows the decline of the inflation rate towards the Bank’s target rate of 2%, even though the target is not theoretically or empirically founded, as argued by the Euromemo Group in previous reports.

The global uncertainty created by the Trump administration’s tariff policies and threatened sanctions against those who retaliate has led to a significant depreciation of the US dollar. Under these conditions, the euro appreciated against the dollar by around 10-12% by late 2025, albeit not threatening the dollar’s dominant position as a reserve currency. Although the ECB President, Christine Lagarde is in favour of strengthening the euro’s international role, Germany retains its ‘reluctant hegemon’ role. Generally, the EU’s institutional arrangements and

⁵ The 23 countries that are members of both NATO and the EU (as of late 2025) are Estonia, Latvia, Lithuania, Finland, Sweden, Denmark, Belgium, France, Germany, Italy, Luxembourg, Netherlands, Portugal, Spain, Poland, Czechia, Hungary, Slovakia, Slovenia, Romania, Bulgaria, Croatia and Greece.

⁶ The main refinancing operations rate is at the time of writing equal to 2.15%, the marginal lending facility to 2.40%, and the deposit facility rate to 2.00%.

macroeconomic policies do not support the Euro's capacity to become a globally dominant reserve currency.

1.3. Proposals for alternatives

In discussing alternatives, a useful starting point is the type of indicators used to measure the economy. Traditionally, this is GDP. This is a blunt instrument that measures activity in terms of output produced, but not that lost due to deteriorating climate conditions, unemployment, widening wealth and income inequality. These aspects are thus discussed in the following chapter dealing with the social and ecological rollback of the present conjuncture. The present chapter concludes with certain proposals about alternatives in relation to the EU macroeconomic policy framework.

In the case of **fiscal policy**, the EU fiscal surveillance framework needs urgent reform. The SGP reference values for the public deficit and the public debt are not theoretically or empirically grounded, as argued in past EuroMemoranda of the EuroMemo Group (EMG). They need to be linked to the fiscal sustainability pattern relevant to each member state depending on such factors as their rate of growth, their fiscal performance and the rate of interest (Frangakis, 2024). In particular, the cost of servicing the public debt is a better indicator of its sustainability over time.

The fiscal rules of the EU need to become friendlier to national investment in terms of spending for a social and environmental transformation. For example, the national escape clause, at present activated in relation to defence spending, may be made wider use of, in order to unlock off-budget loan instruments. Further, to the extent that investment has a high cost at the beginning while the benefits accrue over time, a 'golden rule' exempting investment, or parts of it, from the public debt would be fair to both the present and the future generations. Further, taxing wealth, capital and high incomes to increase fiscal space is preferable to raising public debt. Such taxes contribute to fiscal stability and have highly required positive effects on the distribution of income and wealth.

Also, the use of common borrowing, introduced under the NextGenEU programme and repeated on a smaller scale in relation to defence spending, may be expanded more ambitiously to fund more EU-level investment on the basis of transparency and accountability. However, for such a tool to serve the objectives of a transformational policy, it needs to be embedded in an overall policy of long-term social, economic and ecological transformation.

With regard to private investment, support should be tied to environmental, climate and social conditionalities. Such investment should enhance social cohesion and stakeholder inclusion. As mentioned above, military spending cannot be

'baptised' sustainable thus diverting resources from other uses. Such rebranding is not only misleading. It carries dangerous and long-term implications for environmental and social sustainability.

Monetary policy should support fiscal policy, so that both areas serve the goal of socio-ecological transformation. This is not just a long-run objective. The fiscal authorities need to take advantage of the room for manoeuvre created by the central bank to accelerate such a transformation. The current ECB benchmark rate is favourable for the fiscal authorities. Moreover, central bank policies should be used directly to support public investment that is highly needed e.g. for public housing or to support a just transition.

Further, the ECB should be a buyer of public debt of last resort. The Transmission Protection Instrument (TPI), put in place in 2022, catering for 'deteriorating financial conditions not warranted by country-specific fundamentals' has not been tested in practice, nor is it likely to avert a financial crisis should one happen, as discussed in previous EMG reports.

Overall, the macroeconomic policy framework of the EU is outdated, founded on neoliberal ideas that have been proven wrong many times in the past. Rather than reforming the institutional basis, the European leaders prefer to resort to temporary fixes. Such an approach leads to the accumulation of problems that may become explosive over time. Disappointment and a loss of trust is generated in increasing segments of society, thus opening the way for extreme right-wing notions and practices.

Alternative routes are possible. For these to materialise, good ideas and public debate are necessary, but also social mobilisations that demand a change of course in a radical, progressive direction.

TABLE 1 - BASIC ECONOMIC INDICATORS

Region	Country	Real GDP - % change on preceding year	HICP annual average % change on preceding year	Unemployment - Number of unemployed as % labour force	Real compensation of employees per head - %change over preceding year	Current Account as % of GDP	Net lending (+) or net borrowing (- , general government as % of GDP	Gross debt, general government as % GDP
	Euro area	1.3	2.1	6.3	1.5	2.7	(-) 3.2	88.8
	EU	1.4	2.5	5.9	1.7	2.5	(-) 3.3	82.8
Nordic	Finland	0.1	1.9	9.5	1.3	(-) 0.9	(-) 4.5	88.1
	Denmark	2.0	1.9	6.1	1.5	12.0	2.3	28.9
	Sweden	1.5	2.5	9.0	1.8	4.9	(-) 1.7	34.5
Western Europe	Austria	0.3	3.5	5.6	0.1	1.2	(-) 4.4	81.4
	Belgium	1.0	2.8	6.0	1.7	(-)0.6	(-) 5.3	107.1
	France	0.7	1.0	7.6	1.8	0.0	(-) 5.5	116.3
	Germany	0.2	2.3	3.6	1.7	4.8	(-) 3.1	63.5
	Ireland	10.7	1.9	4.6	0.8	9.7	1.5	33.1
	Luxembourg	0.9	2.3	6.6	1.7	(-)3.6	(-) 0.8	26.8
	Netherlands	1.7	3.0	3.9	2.0	9.1	(-) 1.9	45.2
Southern Europe	Cyprus	3.4	0.9	4.7	3.0	(-) 7.7	3.3	56.4
	Greece	2.1	2.8	9.3	(-) 0.1	(-) 6.2	1.1	147.6
	Italy	0.4	1.7	6.2	1.3	1.0	(-) 3.0	136.4
	Malta	4.0	2.4	3.0	3.4	5.1	(-) 3.2	47.0
	Portugal	1.9	2.2	6.3	2.9	1.1	0.0	91.3
	Spain	2.9	2.6	10.4	1.0	2.7	(-) 2.5	100.0
Eastern Europe	Czechia	2.4	2.3	2.7	2.9	2.2	(-) 1.8	43.4
	Estonia	0.6	4.8	7.6	1.9	(-) 1.5	(-) 1.3	23.4
	Latvia	1.0	3.6	6.8	4.5	(-) 4.1	(-) 3.1	48.3
	Lithuania	2.4	3.4	7.1	5.3	1.5	(-) 2.2	39.8
	Slovakia	0.8	4.2	5.4	1.5	(-) 5.1	(-) 5.0	61.9
	Slovenia	1.0	2.5	3.4	5.3	2.9	(-) 2.2	65.2
	Bulgaria	3.0	3.5	3.5	8.4	(-) 1.8	(-) 3.0	28.5
	Croatia	3.2	4.3	4.7	5.7	(-) 2.9	(-) 2.8	56.2
	Hungary	0.4	4.4	4.5	3.2	0.1	(-) 4.6	73.7
	Poland	3.2	3.4	3.1	5.0	(-) 0.1	(-) 6.8	59.5
	Romania	0.7	5.9	6.1	0.6	(-) 7.9	(-) 8.4	59.1

Source - European Commission, 2025, European Economic Forecast, Autumn 2025, Institutional Paper 327, Nov

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