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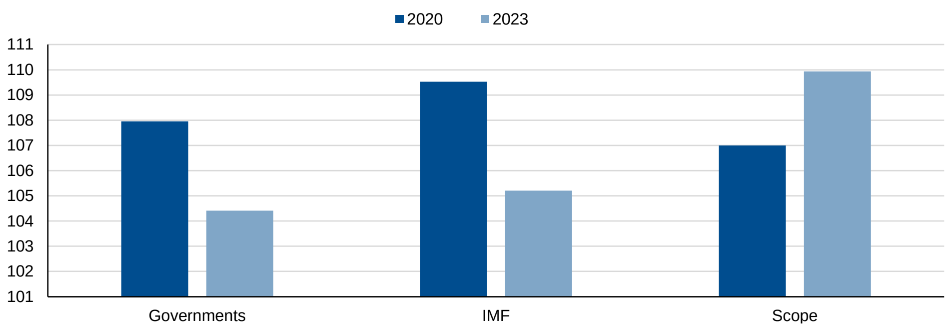
EMU-4: High public debt ratios to stay with crisis-led shift in fiscal-policy paradigm

Countering the Covid-19 pandemic has required governments to loosen fiscal policy and borrow heavily in 2020, raising concerns about how sovereign debt will evolve after the shock. Our analysis of fiscal targets in the four largest euro area economies as outlined in 2021 budgetary plans leads to two conclusions. First, the proposed budgets mirror the EU's shifting paradigm toward counting on growth rather than austerity for fiscal consolidation. Secondly, government forecasts assume effective, long-lasting fiscal impulses from stimulus measures despite challenges such as ageing populations and environment-related adjustment costs. We believe less buoyant growth even with expansionary fiscal policy will prevent the EMU-4's public debt ratios' return to pre-crisis levels for the foreseeable future.

Government debt is set to rise to record highs this year in the Economic and Monetary Union (EMU)-4 in response to the Covid-19 crisis. We expect public debt to increase by between 9pp and 23pp in the four economies, adding up to a weighted aggregate of 107% in 2020 from 90% of GDP at end-2019. Our analysis of the EMU-4's fiscal stances and a comparison of our medium-term fiscal projections with those of the IMF demonstrate that:

- The EMU-4's budget deficits have widened by a similar amount amid fallout from the 2020 pandemic, but the reasons they have increased differs markedly. The dominant role of discretionary fiscal support in Germany contrasts with the impact of automatic stabilisers, such as higher unemployment benefits and/or spending on short-time work schemes, in France, Italy and Spain, induced by more severe recessions in the latter economies;
- The stabilisation and then reduction of debt ratios under IMF forecasts hinge on governments making swift budgetary adjustments despite fairly conservative estimates of future growth;
- Governments themselves are counting on growth for fiscal consolidation, relying on optimistic scenarios for their economies' longer-term growth potential, driven by assumed permanent impacts of fiscal stimulus;
- The shift from fiscal restraint towards a more durable dependence on pro-growth policies constitutes a landmark moment in euro area economic policymaking. However, seizing the opportunity to raise growth potential has to be weighed against risks that growth forecasts may prove too optimistic.

Figure 1: Weighted aggregates of public debt forecasts for EMU-4 (2020-2023*)
in % of GDP



N.B. *Aggregated figures for the EMU-4 based on individual debt sustainability scenarios. Government data for Spain includes Scope's assumptions from 2022-23 regarding the GDP deflator, primary deficit adjustment, interest payments, and stock-flow adjustments.
Source: Draft budgetary plans 2021, IMF World Economic Outlook (October 2020), Scope Ratings GmbH

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Fiscal response to Covid-19: Similar in size, but different composition

Unprecedent increase in 2020 deficits and debt levels

The EMU-4 are confronting larger increases in budget deficits and debt than during the financial crisis in 2009, following the unprecedent shock from Covid-19 on the economies. Fiscal balances will deteriorate by around 7-9pp from 2019 levels while debt to GDP ratios are set to increase by double digits in France, Italy and Spain (**Figure 2**). Turning to the composition of this year's deficits, we observe marked differences between automatic corrections induced by the economic contraction and discretionary action (**Figure 3**).

Pandemic deficits similar in size across EMU-4, but differ in the use of discretionary spending

The expected deterioration in the fiscal balances vis-à-vis pre-shock levels is relatively similar across countries, slightly larger in Italy (8.9pp) and Spain (8.4pp) than in Germany (7.5pp) and France (7.2pp). However, governments report large differences in expenditure and revenue-driving impacts, and especially in the use discretionary fiscal support vis-à-vis automatic spending induced by economic contraction. Germany shows the highest contribution of discretionary measures (6% of GDP), while the relatively soft economic contraction and previous fiscal surplus lower the overall impact of the pandemic on the public deficit (5.7% of GDP). Conversely, Italy, France and Spain show substantial automatic declines in public finances (*light blue bars* in Figure 3) following up to twice as large economic contractions but relatively small discretionary stimulus (*green bars*).

More pronounced recessions hit the debt ratio twice

Following the rise in deficits, governments face large shifts in debt-to-GDP ratios in 2020. We observe an increasing divergence of up to 13pp between moderately indebted countries like Germany and its highly indebted peers. This divergence reflects the double impact of the growth contraction, first on the numerator via the automatic decline of tax revenues and rise in unemployment which leads to more borrowing, and secondly on the denominator, in the drop in output itself.

Figure 2: Debt-to-GDP, %

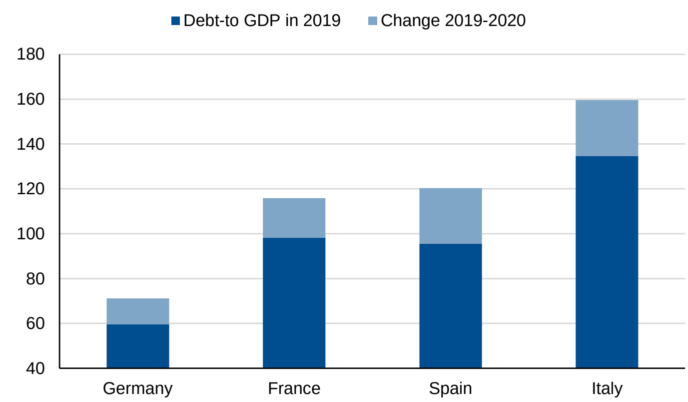
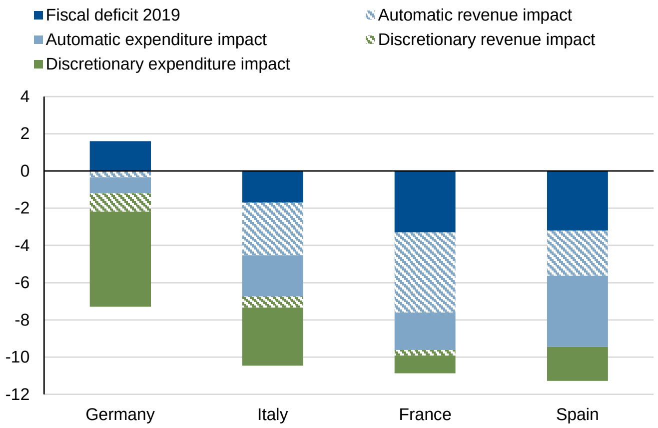


Figure 3: Deficit composition, 2020 (% of 2020 GDP)



Source: Draft Budgetary Plans 2021, Scope Ratings GmbH

Draft budgetary plans serve as baseline for future debt trajectories

Governments have submitted their draft budgets for 2021 in October this year to the European Commission, which include the strong revision of the 2020 budget in response to the pandemic and provide an outlook on future paths for economic growth and public finances.

The key question of this study is how governments project their fiscal balances to evolve in the post-pandemic world. We therefore use the EMU-4's draft budgetary programs submitted in autumn 2020 as a baseline for a discussion of future debt dynamics and sustainability of public finances.

EMU-4: High public debt ratios to stay with crisis-led shift in fiscal-policy paradigm

Medium term fiscal outlook: EU paradigm shift poses one-time opportunity but also risks to debt trajectories

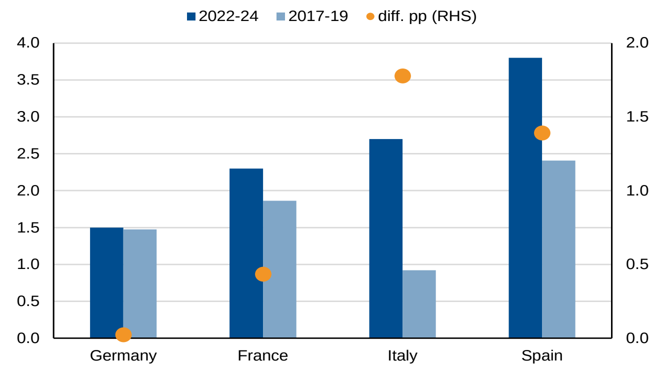
EU paradigm-shift from fiscal restraint towards growth-led consolidation is a single opportunity but…

The EMU-4's consolidation strategies in post-pandemic times focus on maintaining supportive fiscal policy to spur growth over the medium-term. In turn, governments are assuming that consolidation can be achieved by raising their economies' growth potential instead of rapidly adjusting spending. This strategy absorbs the lessons from the global financial and sovereign debt crises – especially in Greece and Italy. Fiscal austerity after the shocks helped to reduce budget deficits in compliance with EU fiscal rules but at the price of slowing growth which resulted in higher debt levels. Today, the EU's suspension of fiscal rules, large expected transfers through the Next Generation EU fund and accommodative ECB policy should allow for countercyclical funding of public deficits and strengthen medium-term growth potential.

…poses risks to increasing debt spiral if growth objectives are not met

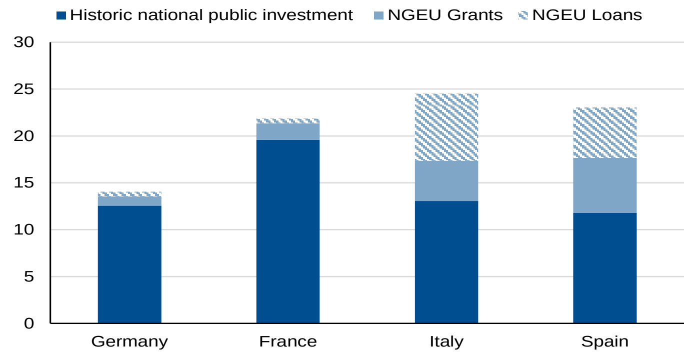
At the same time, this strategy entails risks. If expected robust growth rates do not materialise, large deficits may quickly spiral into steepening debt trajectories, as we currently observe with the rapid deterioration in public finances. As shown in draft budgetary plans for 2021, governments expect at least a prompt return to pre-crisis growth potential, despite possible longer-term structural shifts in economic activity resulting from this crisis. In Spain and Italy, governments even project a doubling (Spain), respectively tripling (Italy) of medium-term growth (**Figure 4**), which would require either a substantial external boost to productivity and/or high and permanent effectiveness of fiscal measures, implying multipliers in the range of 1 to 1.5 times.

Figure 4: Average annual growth rates, %
2022-24: Government projections



*Spain 2024 figure not available and approximated at 2.5%, in line with government expectations of growth potential above 2%

Figure 5: NGEU vis-à-vis public investment in 2014-19
% of 2019 GDP



National public investment proxied with cumulative GFCF in 2014-19; NGEU loans for core Europe estimated at 0.5% of GDP, for Italy and Spain refer to government announcements

Sources: IMF, DBPs 20201, Bruegel, Scope Ratings GmbH

Enhancing growth potential faces implementation risks and structural challenges

Expansionary fiscal policies and the "game changer" Next Generation EU are key opportunities to implement growth-friendly agendas. But such favorable projections contrast with uncertainty around: i) the medium-term fiscal multiplier, ii) implementation risks to the use of the funds, and iii) structural challenges likely to pose downward pressures on growth, including the costs of long-term decline in productivity, ageing societies and environment-related challenges.

Scope expects flat to moderately-increasing debt trajectories

Aware of such risks, we currently expect flat to moderately-increasing debt-to-GDP trajectories from the elevated levels this year for the EMU-4 over the next five years. Debt sustainability is less of a concern in the current low interest rate environment, in view of significant and continuous monetary and fiscal support, and expectations for the euro turning into a more important safe asset. Nevertheless, potential risks may arise in the medium term, should future governments challenge the constructive relationships to the EU and its institutions and/or countries are exposed to new external shocks.

Germany: Sustainable debt levels, but weak future growth potential

Low public investment and demographic change weigh on growth potential

Germany entered the pandemic with solid public finances (debt-to-GDP ratio of 58%) but low real growth (0.56% in 2019). The economy has remained relatively resilient during 2020 compared to neighbors but structural economic challenges weaken the country's medium-term growth potential, in particular its low public investment and a shrinking workforce.

The government currently targets gross public investment spending of 2.75% of GDP by 2021, down from 3% of GDP in 2020. We believe investment remains significantly below the levels required to stimulate Germany's medium-term growth potential, projected at 1.5% by the German government, 1.2-1.3% by the IMF and 1% by Scope (**Figure 6**). Once the temporary fiscal stimulus measures are phased out, the economy requires a substantial productivity push to sustain growth rates of 1.5%, which we think is optimistic at this stage.

Conservative fiscal roadmap ahead

Compared with IMF projections at around -8.2%, the 2020 headline deficit as planned by German authorities reaches around -6.3% of GDP. This is mostly based on different assumptions for the primary deficit. The parliament has authorised additional borrowing of maximum EUR 217.8bn in 2020 (6.6% of GDP), of which around EUR 204bn were placed in debt auctions by end-September. Scope assumes that a substantial share of the debt will be transferred into 2021 despite up to EUR 10bn-24bn additional expenditure earmarked for business affected by economic restrictions in November.

Real GDP (%)	2019	2020	2021	2022	2023	2024
IMF	0.6	-6.0	4.2	3.1	1.8	1.3
Government	0.6	-5.8	4.4	1.5	1.5	1.5
Scope	0.6	-5.6	4.0	2.0	1.0	1.0

Primary balance, % of GDP	2019	2020	2021	2022	2023	2024
IMF	2.1	-7.6	-2.7	1.0	1.2	1.4
Government	2.1	-5.5	-3.8	-1.5	-0.3	0.3
Scope	2.1	-6.0	-3.0	-2.5	-2.0	-1.0

For 2021, the German government remains more conservative than the IMF with an anticipated primary deficit of 2.7% of GDP while the government plans with 3.8% of GDP. German authorities anticipate a return to compliance to medium-term budgetary objectives by 2023 after the phasing out of temporary measures included in its stimulus plan. In line with growth projections, the government expects a maximum structural deficit of 0.5% of GDP by 2023.

Scope anticipates prolonged phase of higher public debt

Low interest payments and a less severe shock to output levels have exposed Germany less than neighbours to the pandemic. However, it is Scope's view that the higher debt stock (at levels around 70% of GDP) is unlikely to be brought down to pre-crisis levels in the near term given the country's weak growth potential and expected materialisation of contingent liabilities, including higher expenditure on health care. With its still moderate public debt levels, the German economy – including public finances longer term – could instead benefit from higher public investment into infrastructure, education and research at the expense of postponed consolidation or temporary higher debt levels. The current budget plans, however, see public investment more than one percentage point below the 4% of GDP average of Germany's AAA-rated sovereign peers: the Netherlands, Luxembourg and Austria.

We expect Germany to be the only country among the EMU-4 with a fully stable debt trajectory, thanks to a prudent fiscal framework and moderate debt levels. At the same time, the country's low growth potential at the start of this crisis, a mostly demand-side oriented stimulus program and lack of structural supply-side oriented plan remain medium-term challenges for policymakers.

Figure 6: DE: Government vis-à-vis IMF projections, pp

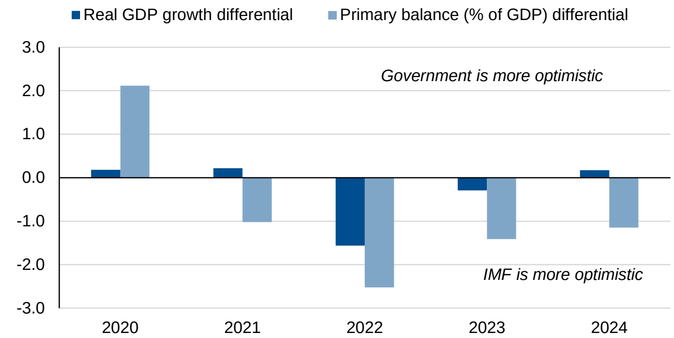
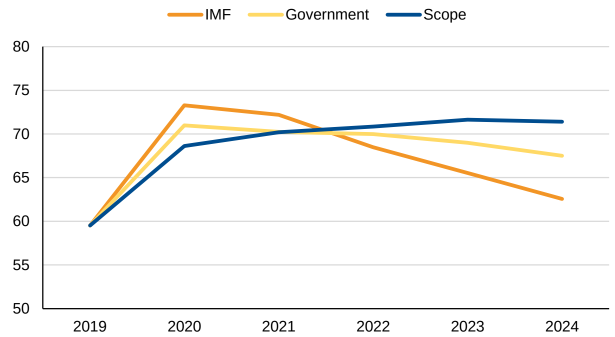


Figure 7: DE: Government debt, % of GDP



Source: IMF, German Finance Ministry, Scope Ratings GmbH

France: Debt sustainability out of reach near-term

Revised budget raises public debt levels further by 2021

The French economy is severely hit by the pandemic and likely to see another substantial downward revision to GDP in 2020 as the government has renewed economic restrictions. The government anticipates a total real contraction of 11% this year, down from a projected 10% in October. Medium-term growth projections hinge on assumptions for the pace of recovery and successful implementation of the supply-side oriented "France Relance" plan (EUR 100bn stimulus package). Official plans show more optimism over the short-term with a real recovery of 8% by 2021, while the IMF anticipates higher growth rates near 2% over the medium-term horizon (**Figure 8**).

Real GDP (%)	2019	2020	2021	2022	2023	2024
IMF	1.5	-9.8	6.0	2.9	2.3	1.9
Government	1.5	-11.0	8.0	3.5	2.0	1.4
Scope	1.5	-11.0	7.0	2.0	1.5	1.4

Primary balance, % of GDP	2019	2020	2021	2022	2023	2024
IMF	-1.6	-9.5	-5.3	-4.2	-3.8	-3.6
Government	-1.6	-9.9	-5.4	-3.8	-2.9	-2.2
Scope	-1.6	-10.0	-5.0	-4.0	-3.0	-2.5

see footnote[1]

Budgetary projections in France are closely tied to growth outlooks. The IMF assumes a continued fiscal stimulus to support growth in forthcoming years (primary deficit projected at around 3.5% until 2024), while the government plans to fulfill the Maastricht criteria by 2025. Scope's more conservative stance reflects smaller fiscal multipliers over the medium-term, resulting in a slower recovery with elevated deficits.

Growth potential is crucial for medium-term debt sustainability

Under President Emmanuel Macron, the government has managed to lift the country's growth potential by around 0.2 percentage points before the pandemic. However, the reforms came at the cost of prevailing structural fiscal deficits. The government is expected to keep track of its structural reform program, with important new elements added after the crisis, which could further benefit medium-term growth. At the same time, fiscal consolidation remains a lesser priority, partly given the record-low interest rate environment. In turn, the main question for French debt sustainability revolves around the government's ability to effectively implement reforms, requiring future GDP growth of around 1.4-1.5% per annum to stabilise the high public debt levels.

Scope recognises elevated uncertainty for debt sustainability

Medium-term debt projections capture different assumptions on the French growth outlook and budgetary plans. The draft budgetary plan by the French government remains the most optimistic compared to IMF and Scope, both expecting at best a stabilisation of the country's debt-to-GDP ratio at levels above 120% until 2024. The government's projection relies on favourable growth projections for the recovery in 2021 (8% of GDP) and smooth reduction of the primary deficit averaging around 1pp. per year between 2022-24. The differences between Scope and the IMF are explained by medium-term growth projections in 2023/24 (1.8% at the IMF versus 1.4% by Scope)

[1] Scope has updated the growth and budgetary forecasts from French DBP following latest announcements by the French Finance Ministry.

while expectations for the deficit are more conservative in both projections compared to those provided by the government.

Overall, France's debt projections are closely linked to the government's ability to raise growth potential while debt adjustments via the budget appear less likely in view of France's history of weak consolidation and traditionally large public sector. Important is to note that Scope and IMF assume a further increase of France's debt trend after 2021 unless the government manages to bring down the deficit quickly and/or manages to speed up recovery.

Figure 8: FR: Government vis-à-vis IMF projections, pp

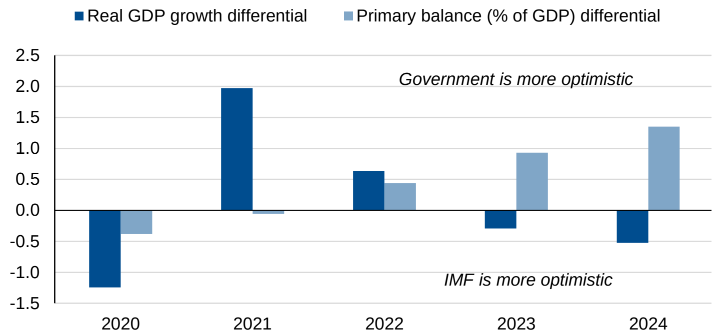
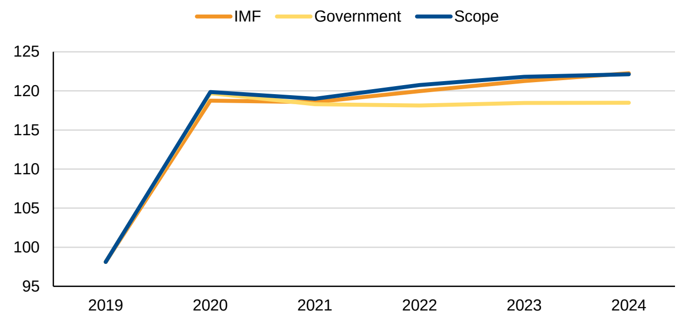


Figure 9: FR: Government debt, % of GDP



Source: IMF, French Finance Ministry, Scope Ratings GmbH

Italy: Last call to raise growth, with high indebtedness hard to trim

Italy's budgetary strategy: betting on growth to ensure fiscal sustainability

The Italian government's budgetary strategy, as outlined in the 2021 Draft Budgetary Plan (DBP), is based on supportive fiscal policy over the coming years, and a return to primary surpluses only by 2023. However, robust growth achieved thanks to structural reforms and increased investment would bring the public debt ratio back to pre-crisis levels by 2031. The plan includes full recourse to European fiscal initiatives, through the SURE unemployment benefits scheme and the Next Generation EU fund (NGEU, EUR 205bn allocated to Italy over 2021-26). Essentially, the government aims to ensure debt sustainability via the growth channel, rather than via immediate fiscal adjustment. Following a track record of primary surpluses but anaemic growth over the past decade pre-crisis, with, however, no material improvements in public debt levels, this crisis has offered the opportunity for policymakers to rethink their fiscal strategy.

Short-term growth outlook: downside risk from new lockdown measures

For 2020 as well as next year, we forecast a 2020 GDP contraction and 2021 rebound of similar sizes as the latest expectations from the Italian government. However, downside risks have re-emerged, in conjunction with the extended second wave of coronavirus that has led the government to implement 'lite' lockdown measures in certain regions. The country's fiscal watchdog (Ufficio Parlamentare di Bilancio) quantifies the additional drop in 2020 GDP at around 1-2pps.

Real GDP (%)	2019	2020	2021	2022	2023	2024
IMF	0.3	-10.6	5.2	2.6	1.7	0.9
Government	0.3	-9.0	6.0	3.8	2.5	1.8
Scope	0.3	-9.5	5.6	2.0	1.0	0.7

Primary balance, % of GDP	2019	2020	2021	2022	2023	2024
IMF	1.6	-9.4	-2.8	-0.7	0.3	0.4
Government	1.6	-7.0	-3.8	-1.6	0.1	n.a
Scope	1.6	-7.4	-4.4	-2.7	-1.1	0.1

See footnote[2]

Medium-term growth potential: implementation risks and weak fundamentals

Our view differs substantially from government projections in regard to Italy's medium-run growth outlook. We anticipate a steady convergence towards the economy's pre-crisis growth potential (of 0.7%) after a post-crisis growth rebound next year. The government,

[2] The Italian government is studying an emergency additional stimulus package for the 2021 DBP in connection with recent newly implemented lockdown measures, which could result in an additional primary balance deterioration of around 1% of GDP in 2021 and a slower fiscal adjustment in following years.

instead, expects growth to remain robust over the medium term, converging to 1.4% by 2026. While Italy's no-policy-change scenario forecasts are in line with IMF forecasts (but more optimistic than ours), the government expects a permanent impact on future growth from fiscal policy changes. For 2021, as an example, 0.6pp of the 0.9pp in added growth is expected to come from fiscal policy, including the VAT-increase cancellation, while resources from the EU recovery fund are set to be the most relevant fiscal-stimulus growth driver in later years. Italy estimates that it will use EU resources in the amount of 2% of GDP per year on average for three consecutive years, with an expected impact on (real) growth of 0.5pp per annum. The government's assumed fiscal multiplier appears conservative, given that most of the extra resources will be attributed to investment expenditure; however, the key downside risk does relate to the capacity of the Italian public sector to channel in a timely and effectively manner the funds to productive investment areas. Italy has displayed one of the lower absorption rates of EU funds in EU member countries over previous allocation periods. While some of the reform proposals, such as a programme to incentivise private investment (Industria 4.0) and the cutting of one of the highest tax wedges among EU member states could support growth, it is Scope's opinion that the ambitious target of increasing the public investment share in GDP to above the EU average and the streamlining of judicial and bureaucratic systems remain challenging with significant implementation risk.

Weak economic fundamentals, including an ageing population and a lack of labour productivity growth over the past twenty years, remain structural impediments to a substantial lift in growth potential. Italy's GDP has not grown by more than 1.7% a year since 2006, even during periods of rapid economic rebound after shocks.

Expectations of a more prolonged fiscal adjustment period and risk from contingent liabilities

Italy's fiscal policy is set to remain expansionary over the next three years, with an added 1.3pp[1] to the fiscal deficit under government projections compared with its no-policy-change scenario in 2021 due to discretionary measures. In the context of the second wave of coronavirus, additional fiscal support actions may be implemented by the end of the year. The IMF, by contrast, expects a swift return to fiscal prudence by next year, with the primary deficit improving from 9.4% of GDP this year to 2.8% in 2021, despite its more conservative assumptions on growth. We expect a more prolonged fiscal adjustment period, informed partly by our more conservative medium-run growth outlook, with our assumptions, moreover, broadly in line with government expectations for gradual structural fiscal adjustments after this year's significant stimulus actions (totalling 6% of GDP). The government forecasts also include stock-flow adjustments (of 0.6% of GDP per year), which raise the debt-to-GDP ratio, possibly tied to materialisation of contingent liabilities related to public guarantees on loans (which total 40% of GDP).

We expect a flat debt trajectory around current elevated levels over the medium term

The authorities' projections for a reduction in Italy's debt ratio of more than 23pps by 2030 look optimistic. These forecasts are driven by assumptions of sustained primary budget surpluses, which increase to 2.5% of GDP by 2026, as well as robust growth, averaging 1.6% per year over 2024-26. We expect instead a fairly flat trajectory for the public debt ratio, at around 160% of GDP.

EMU-4: High public debt ratios to stay with crisis-led shift in fiscal-policy paradigm

Figure 10: IT: Government vs IMF projections, pp

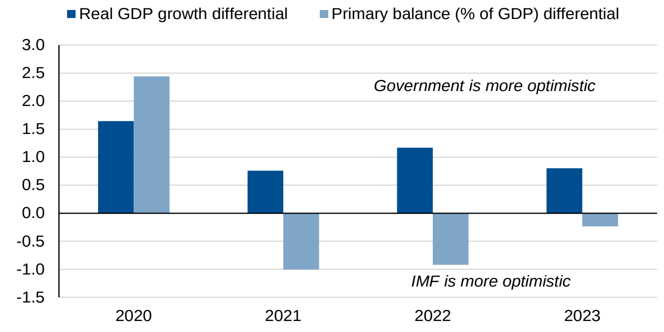
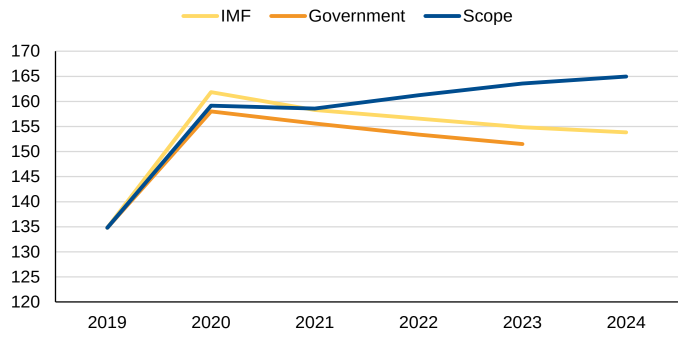


Figure 11: IT: Government debt, % of GDP



Source: IMF, Italian Ministry of Economy and Finance, Scope Ratings GmbH

Spain: large fiscal deterioration requires fast and buoyant recovery

Short-term growth outlook: downside risk from new State of Alarm…

In the 2021 Draft Budgetary Plan, the Spanish government projects a vigorous economic rebound, driven already next year, by NGEU recovery transfers. The government expects an economic recovery of 9.8% in 2021 after this year's 11.2% contraction, when including the EU funds impulse. We see, however, significant downside risk to the economic outlook, with negative spillovers to the government's fiscal and debt projections.

First, the extended second wave of contagion has led the government to approve a new State of Alarm by the end of October, including a curfew and delegating powers to regions to impose further restrictions on mobility and economic activities. While the restrictions are less severe vis-à-vis containment measures during the spring, they are likely to further expand the 2020 GDP contraction, and to weigh on the 2021 recovery.

…and strongly dependent on high fund absorption and large multiplier

Secondly, we note that the budgetary outlook hinges on the assumption that a large tranche of EU funds, around EUR 27bn (2.2% of 2019 GDP), will fully come into effect next year. These funds, in most part allocated to investment expenditure, would raise Spain's GDP growth by around 2.6pp in 2021 compared to a 7.2% growth forecast in a no-policy scenario. Such significant implied boost on growth compares with a much more modest estimates from the Bank of Spain, which projects the impact on growth of 10bn of NGEU funds in the range of 0.2-0.3 pp per annum[3].

The capacity to utilise timely and efficiently such a large amount of funds may represent a key challenge for the Spanish public sector. In fact, at 39%, Spain has the second lowest cumulative 2014-20 absorption rate of European Structural and Investment Funds among the EU-28, in line with Italy. In this sense, the government has taken steps to reinforce the governance of the plan in the direction of centralising control in the Cabinet Office and plans to undertake reforms of administrative processes to speed up procurement.

Real GDP (%)	2019	2020	2021	2022	2023	2024
IMF	2.0	-12.8	7.2	4.5	3.4	2.8
Government	2.0	-11.2	9.8	4.7	4.2	n.a
Scope	2.0	-12.0	7.0	2.5	2.0	1.6

Primary balance, % of GDP	2019	2020	2021	2022	2023	2024
IMF	-0.8	-11.7	-5.1	-3.4	-2.4	-1.7
Government	-0.6	-9.0	-5.5	n.a	n.a	n.a
Scope	-0.6	-11.0	-6.5	-3.5	-2.5	-2.0

Medium-term growth potential boosted by the government agenda

The government expects the EU funded "Plan Nacional de Recuperacion, Transformacion y Resiliencia" to provide sustained support to growth also in the medium term, with growth well above potential also in 2022-23. The Plan is rooted in four general spending programs - ecological transition, community development, digitalization and gender equality- and seeks to encourage public investment and modernize the Spanish economy. It will be financed by the Next Generation EU stimulus plan, which will enable Spain to obtain up to 140bn in financing. The government plans to use the EUR 73bn in

[3] Bank of Spain, Economic Bullettin 2/2020, "The macroeconomic impact of the Next Generation EU Programme under various alternative scenarios"

grants over the first three years and then, possibly, recur to loans if needed. The government projects the creation of 800,000 additional jobs and a permanent raise in Spain's annual growth potential beyond 2%. This compares with our more conservative view, assuming medium-term expansion to converge rapidly to around 1.5% per annum.

Fiscal strategy includes driving higher revenues from wealthy groups to investment spending

The authorities' favorable macroeconomic outlook is reflected in fiscal projections. A large rebound next year is necessary to quicky close the double-digit deficit, where instead, a slower adjustment path could spiral in a fast increase in the debt-to-GDP ratio. For the current year the government reports an expected fiscal deficit at 11.3% of GDP[4] and 7.7% in 2021. This compares to our more conservative forecasts of fiscal deficits at 13% of GDP in 2020 and 8.5% in 2021. Authorities present no fiscal projections beyond 2021. The IMF expects a faster recovery in the primary balance next year vis-à-vis the Spanish government, despite more conservative recovery assumptions. Besides EU financing to boost public investment, the government plans to increase taxes on large companies and wealthy earners and use of proceeds to increase healthcare funding by EUR 3bn and doubling infrastructure investment to EUR 11bn. Authorities also take into account significant stock flow adjustments for next year, with a 2.5pp increase in the debt-to-GDP ratio, which possibly includes expectations around the materialization of contingent liabilities related to public guarantees on loans (EUR 160 bn or 14% of GDP).

The IMF projects a flat debt-to-GDP trajectory for Spain, but with a higher public debt ratio in 2025 (119% of GDP) than foreseen by the Spanish authorities already for next year (117%). Conversely, we expects the public debt-to-GDP ratio to remain on an increasing trajectory over the medium term, from 122% this year to 125% by 2025 under a scenario of real growth in line with the country's pre-crisis growth potential and fiscal deficits beyond 3% over the medium-term.

Figure 12: ES: Government vis-à-vis IMF projections, pp

* Primary balance projections from the government available only until 2021

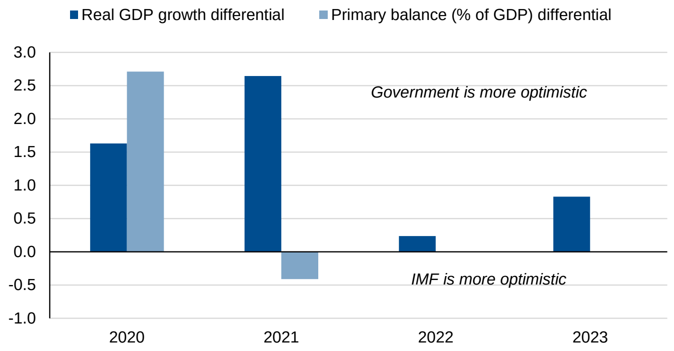
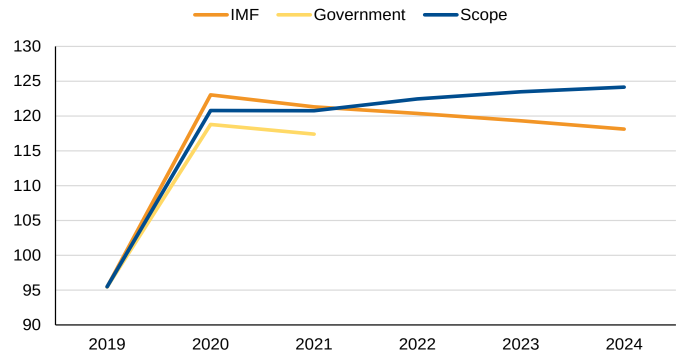


Figure 13: ES: Government debt, % of GDP



Source: IMF, MEF, Scope Ratings GmbH

[4] The Spanish government could implement further stimulus measures for 2020, to restore businesses most-hit from recently implemented quasi-lockdown measures.

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