IMF Country Report No. 26/177

EURO AREA POLICIES

July 2026

2026 ANNUAL CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MEMBER COUNTRIES

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2026 Annual Consultation with member countries, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 13, 2026 consideration of the staff report that concluded the annual consultation.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 13, 2026, following discussions that ended on May 13, 2026, with the officials of EU institutions on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 26, 2026.
- A **Statement by the Executive Director** for Italy and EURIMF President, on behalf of the euro area member states and the European community.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR26/247

IMF Executive Board Concludes 2026 Consultation with Euro Area

FOR IMMEDIATE RELEASE

- The war in the Middle East has weakened the euro area outlook, with growth projected to slow from 1.4 percent in 2025 to 0.9 percent in 2026 and 1.2 percent in 2027 and headline inflation projected to rise from 2.1 percent in 2025 to 2.9 and 2.3 percent, respectively.

- Risks are skewed toward weaker growth and higher inflation, with the extent of energy market disruption from the war in the Middle East being the largest source of uncertainty.

- Monetary policy should aim to keep inflation expectations anchored and fiscal policy should mitigate the war's harm to activity while remaining prudent. Structural fiscal consolidation remains a priority, especially in high-debt countries. Reforms should focus on strengthening energy security, deepening the single market, and lifting medium-term growth.

Washington, DC – July 16, 2026: On July 13, 2026, the Executive Board of the International Monetary Fund (IMF) completed the 2026 discussions on common euro area policies with member states.[1] The authorities have consented to the publication of the Staff Report prepared for this consultation.[2]

Following a period of growth at potential and inflation at target, the euro area outlook has weakened. The effects of the war in the Middle East include weaker confidence, tighter financial conditions, and inflationary pressures. . Growth is projected at 0.9 percent in 2026 and 1.2 percent in 2027—0.5 and 0.2 percentage points below pre-war estimates—while headline inflation is projected at 2.9 percent in 2026 and 2.3 percent in 2027.

Risks are skewed toward weaker growth and higher inflation. A slower restoration of global energy supply would dampen growth and raise inflation further, even as a drop in confidence or financial stress could weaken demand. Further intensification of the war in Ukraine, or

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. Staff hold separate annual discussions with the regional institutions responsible for common policies for the countries in four currency unions – the Euro-Area, the Eastern Caribbean Currency Union, the Central African Economic and Monetary Union, and the West African Economic and Monetary Union. For each of the currency unions, staff teams visit the regional institutions responsible for common policies in the currency union, collect economic and financial information, and discuss with officials the currency union's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis of discussion by the IMF Executive Board. Both reports subsequently are considered an integral part of the Article IV consultation with each member.

[2] Under the IMF's Articles of Agreement, publication of documents that pertain to member countries is voluntary and requires the member consent.

renewed disruptions and uncertainty from tariffs and trade policies, could weigh on activity more strongly or for longer than expected. Financial stability risks have risen with the weaker outlook and could increase further if a sharp global risk-off episode were to amplify negative wealth effects, or if balance sheet stress in leveraged nonbank financial institutions (NBFIs) arose and propagated to banks and core funding markets.

A carefully calibrated policy response is needed to manage the macroeconomic consequences of the current shock while advancing structural reforms to boost medium-term growth and resilience. The immediate priority is to keep inflation expectations anchored and cushion the impact of the shock within available fiscal space. These efforts should remain consistent with the longstanding structural agenda to strengthen Europe's energy security, economic resilience, and potential growth.

Executive Board Assessment[3]

Executive Directors noted that while the euro area entered 2026 from a position of strength, energy supply disruptions linked to the war in the Middle East have weakened the outlook by raising inflation and dampening growth. A number of Directors also reiterated the continued impact of Russia’s war in Ukraine. Directors recommended a prudent, state-contingent policy mix that balances maintaining macroeconomic stability and fiscal sustainability when managing the shock, while also advancing reforms to boost resilience, productivity, and medium-term growth.

Directors supported a data-dependent and well-communicated monetary policy that is focused on maintaining price stability and well-anchored inflation expectations by calibrating the response to the evolving inflation outlook. They broadly agreed that monetary policy communication underpinned by continued use of scenario analysis could help guide expectations given high uncertainty.

Directors agreed that the fiscal policy response to the current shock should rely on automatic stabilizers, and that any discretionary support should be temporary and targeted and preserve price signals. They emphasized the need for credible medium-term plans to safeguard fiscal sustainability, which should be underpinned by expenditure prioritization, efficiency gains, structural reforms, and effective implementation of the EU fiscal framework.

Directors agreed that deepening the single market remains the most effective way to strengthen growth and resilience. They welcomed efforts to reduce cross-border barriers, including through a proposed voluntary 28th regime, and called for measures to improve labor mobility, including effective integration of migrants, and AI readiness. Directors emphasized that achieving greater energy security requires further efforts to deepen energy market integration and advance the energy transition. They also stressed the need to advance the Savings and Investments Union and broadly agreed that the digital euro could enhance payments efficiency and deepen financial integration. Directors concurred that strengthening

[3] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

the EU budget and its financing framework would help support common priorities and resilience.

Directors welcomed the EU's continued trade diversification efforts and its support for an open, rules-based trading system. They concurred that policies aimed at reducing external supply vulnerabilities should be targeted in order to limit economic distortions, fiscal costs, and adverse spillovers, while building longer-term resilience.

While noting the banking system's resilience, Directors called for continued monitoring of vulnerabilities from stretched asset valuations and growing NBFI activity. They supported implementation of the FSAP recommendations, in particular to strengthen system-wide stress testing, data collection and sharing, supervisory capacity, and the AML/CFT framework. Directors stressed the need to further strengthen the financial safety net through stronger resolution frameworks and completion of the Banking Union, while ensuring that regulatory simplification does not weaken prudential standards and that Basel III is fully and timely implemented. They agreed that stablecoins require continued monitoring as well as strong cross-border supervisory cooperation and regulation.

Table 1. Euro Area: Main Economic Indicators, 2021–2031[1]

(y/y percent change, unless otherwise specified)

					Projections 1/					
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Demand and Supply										
Real GDP	3.6	0.5	1.0	1.4	0.9	1.2	1.4	1.2	1.1	1.1
Private consumption	5.3	0.5	1.3	1.4	0.9	1.1	1.3	1.2	1.1	1.0
Public consumption	1.3	1.5	2.3	1.4	1.9	1.3	1.0	1.0	1.1	1.1
Gross fixed investment	2.1	2.6	-2.4	3.0	1.3	1.5	1.9	1.7	1.5	1.3
Final domestic demand	3.7	1.2	0.7	1.8	1.2	1.2	1.4	1.2	1.2	1.1
Stockbuilding 2/	0.4	-1.1	0.0	0.2	-0.1	0.0	0.0	0.0	0.0	0.0
Domestic demand	4.0	0.1	0.7	2.0	1.1	1.2	1.4	1.2	1.1	1.1
Foreign balance 2/	-0.2	0.4	0.3	-0.5	-0.2	0.0	0.0	0.0	0.0	0.0
Exports 3/	7.4	-1.2	0.6	2.1	1.1	2.5	2.5	2.6	2.5	2.5
Imports 3/	8.4	-2.0	0.0	3.5	1.6	2.6	2.7	2.7	2.7	2.6
Resource Utilization										
Potential GDP	1.2	1.0	1.4	1.4	1.1	1.2	1.2	1.1	1.1	1.1
Output gap 4/	0.8	0.3	-0.1	-0.1	-0.3	-0.3	-0.1	0.0	0.0	0.0
Employment growth	2.4	1.5	1.0	0.8	0.2	0.2	0.2	0.2	0.1	0.0
Unemployment rate 5/	6.7	6.5	6.4	6.3	6.3	6.2	6.1	5.9	5.9	5.9
Prices										
GDP deflator	5.3	6.1	3.0	2.5	2.5	2.4	2.2	2.1	2.1	2.0
Consumer prices	8.4	5.4	2.4	2.1	2.9	2.3	2.2	2.0	2.0	2.0
Public Finance (percent of GDP)										
Overall fiscal balance	-3.4	-3.5	-3.0	-3.0	-3.5	-3.5	-3.3	-3.2	-3.1	-3.7
Primary balance	-1.9	-2.1	-1.5	-1.4	-1.6	-1.6	-1.3	-1.0	-0.9	-1.3
Structural balance 4/	-3.6	-3.7	-3.1	-3.0	-3.3	-3.4	-3.4	-3.3	-3.3	-3.8
Structural primary balance 4/	-2.1	-2.3	-1.5	-1.4	-1.5	-1.5	-1.3	-1.2	-1.0	-1.4
General government gross debt 6/	88.9	86.5	86.6	87.4	88.4	88.8	89.1	89.5	89.9	92.9
Debt of the EU institutions 7/	0.6	0.9	1.5	...	...	...	...	...	...	...
External Sector (percent of GDP) 8/										
Current account balance	-0.2	1.7	2.7	1.7	1.1	1.3	1.5	1.6	1.7	1.8
Interest Rates (percent, end of period) 9/										
Euro short-term rate (€STR)	1.9	3.9	2.9	1.9	1.9	...	...	...	...	...
10-year government benchmark bond yield	3.0	2.9	2.8	3.2	3.5	...	...	...	...	...
Exchange Rates (end of period) 9/										
U.S. dollar per euro	1.1	1.1	1.0	1.2	1.2	...	...	...	...	...
Nominal effective rate (2005=100)	96.1	97.4	96.1	101.6	100.2	...	...	...	...	...
Real effective rate (2005=100, ULC based)	84.9	88.8	88.3	92.8	...	...	...	...	...	...

Sources: European Central Bank; Eurostat; and IMF staff estimates.

1/ Projections for 2026-2031 are based on July WEO 2026 projections of France, Germany, Ireland, Italy, Netherlands, and Spain (accounting for around 85% of EA GDP) and April 2026 WEO projections for others.

2/ Contribution to growth.

3/ Includes intra-euro area trade.

4/ In percent of potential GDP.

5/ In percent.

6/ General government gross debt is defined as the consolidated gross debt of the whole general government sector.

7/ The debt is percent of EU GDP and this includes debt financed by the EU budget, the European Stability Mechanism, the European Financial Stability Facility, the Single Resolution Board/Single Resolution Fund, the Modernisation Fund, the Joint Sickness Insurance Scheme, and the European Peace Facility, net of EU institutions' claims on member states—such as on-lent funds already reflected in national debt statistics.

8/ Projections are based on member countries' current account aggregations excluding intra-euro flows and corrected for aggregation discrepancy over the projection period.

9/ Latest available monthly data for 2026.

INTERNATIONAL MONETARY FUND

EURO AREA POLICIES

June 26, 2026

STAFF REPORT FOR THE 2026 CONSULTATION WITH MEMBER COUNTRIES ON COMMON EURO AREA POLICIES

KEY ISSUES

Context. The euro area economy had displayed resilience before the war in the Middle East started. In 2025, GDP growth ran slightly above potential, inflation was close to target for most of the year, the output gap was broadly closed, and the current account surplus narrowed. The external position is assessed as broadly in line with medium-term fundamentals and desirable policies.

The near-term outlook has deteriorated amid the war in the Middle East. Despite the agreement announced on June 15 on a framework to end hostilities, uncertainty remains about how soon energy supply disruptions will be resolved. As a result, it is unclear how long energy prices will remain elevated relative to pre-war levels and how their impact will transmit and amplify through the economy—underscoring the difficult balancing act facing policymakers. These near-term challenges are layered on top of Europe's persistently weak potential growth that reflects subdued productivity growth and aging. Geoeconomic fragmentation and fast technological progress have raised the stakes for Europe. Efforts to mitigate external risks through trade diversification or the expansion of domestic capabilities can entail fiscal costs and lower efficiency, making careful cost-benefit assessment essential. At the same time, advances in digital and clean energy technologies are reshaping production and investment, with important implications for productivity and financial intermediation.

Outlook. The war in the Middle East and the associated energy price surge have raised near-term inflation expectations and upside risks to inflation, and weakened the growth outlook. Under the July WEO baseline, the war-related energy shock is assumed to be modestly amplified through confidence and financial conditions. Relative to the pre-war forecast, this would reduce growth by 0.5 percentage point in 2026 and 0.2 percentage point in 2027 (to 0.9 and 1.2 percent, respectively), while raising headline inflation to 2.9 and 2.3 percent, respectively, and core inflation to 2.3 percent in both years. However, activity and inflation could evolve along different paths depending on the propagation of the shock.

Policy priorities. Remaining uncertainty around energy supply disruptions and their transmission calls for a state-contingent macroeconomic policy response, alongside progress on reforms to strengthen medium-term growth and resilience. Advancing fiscal and structural reforms that boost growth prospects and contain risks to financial stability would lift private investment, preserve external stability, and minimize adverse outward spillovers

- *Monetary and fiscal policy should be carefully calibrated to contain inflation pressures while mitigating downside risks to activity.* Monetary policy should remain focused on anchoring inflation expectations, while fiscal policy should preserve sustainability amid rising long-term spending pressures, supported by credible medium-term adjustment under the EU fiscal framework. Any extension of existing energy support measures or new measures, if deemed necessary, should be well-targeted, temporary, and preserve price signals to facilitate energy demand adjustment and limit adverse spillovers to other energy-importing economies. Broad-based fiscal support is not warranted, as, in addition to further straining public finances, it could necessitate more forceful monetary policy action to limit second-round effects.

- *Interventions to build resilience to external supply risks—amid a more fragmented global environment—should carefully weigh their economic costs.* The energy shock reinforces the case for accelerating the energy transition and EU energy market integration.

- *Deepening the EU single market remains a key win-win, supporting growth and resilience.* Priorities include a 28th corporate regime and the completion of the savings and investments union, backed by consistent national implementation of EU rules and avoidance of national gold-plating. Advancing the digital euro can enhance the efficiency of pan-EU retail payments and support single market integration.

- *Constructively resolving trade tensions, implementing recently concluded trade agreements, and strengthening the rules-based multilateral trading system* would reduce trade policy uncertainty and support deeper trade diversification and integration.

- *Rising financial sector risks—including from NBFIs—call for stronger system-wide oversight, effective supervisory cooperation, and resilient safety nets*. Ongoing efforts to simplify EU financial regulation should not dilute prudential standards, and Basel III requirements should be implemented fully and without further delay.

Approved By
Oya Celasun (EUR) and Mark Flanagan (SPR)

Discussions took place in Brussels (Belgium), Frankfurt (Germany), Luxembourg, and Paris (France) during April 30–May 13, 2026. Mission members include M. Nabar (head), L. Brandao, H. Lin, R. Beyer, F. Caselli, A. Dizioli, A. Fotiou, R. Varghese, J. Yoo (all EUR), joined by J. John, H. Hesse, F. Toscani, and J. Frie (all EUO). A. Jakubik (SPR), C. Cuervo (MCM), and O. Celasun (EUR Front Office Reviewer) participated in select meetings with the ECB and the European Commission. The Executive Director, R. Ercoli, and J. Guigue (both OED), R. Rüffer (ECB observer at the IMF) and L. Abraham (ECB advisor at the IMF), joined the meetings. K. Cerrato, M. Maneely, H. Tong, and K. Qin (all EUR) supported the mission from HQ.

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CONTEXT

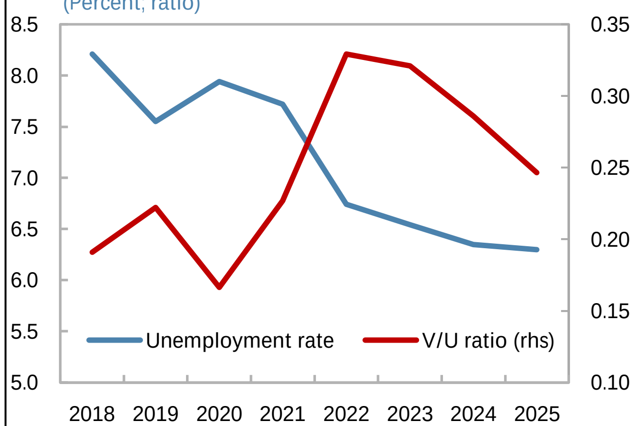
1. The euro area economy, initially set to grow modestly with inflation at target, now faces a worsened outlook amid supply disruptions because of the war in the Middle East. The associated surge in energy prices has raised near-term inflation expectations and upside risks to inflation, and weakened the growth outlook. The current juncture calls for a prudent macro-financial policy mix that secures inflation at target over the medium term, allows automatic stabilizers to alleviate the growth impact, and guards against financial sector risks. Uncertainty about the duration of the energy supply disruptions and the transmission of high energy prices to inflation and activity underscores the challenges confronting policymakers—they must carefully balance deploying measures to cushion the blow for households and firms, preserving policy space, and avoiding initiatives that impede necessary structural adjustments.

2. These near-term challenges are layered on top of Europe's persistently weak potential growth and pressing structural policy issues. Geoeconomic fragmentation, increasing competition for Europe's manufacturing exports, and fast technological progress have raised the stakes for both medium-term growth and economic resilience. Even before the war in the Middle East began, European policymakers were already seeking to address vulnerabilities from external linkages and strengthen economic resilience. Efforts to mitigate external risks can inflict fiscal costs and often involve tradeoffs between economic resilience and efficiency. Meanwhile, advances in digital and clean energy technologies, tokenization, and payment systems have the potential to significantly affect productivity, financial intermediation, and the evolution of the international monetary system, with possibly profound implications for Europe's position and the role of the euro in the global economy. Appropriate policy choices can turn these shifts into opportunities for Europe.

RECENT DEVELOPMENTS

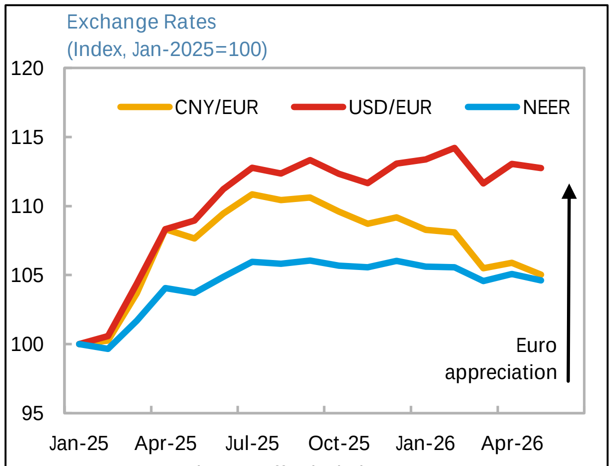
3. Before the onset of the war in the Middle East, the euro area economy had been growing at potential, with domestic demand countering external headwinds from the war in Ukraine and higher US tariffs. In 2025, the economy expanded by 1.4 percent (slightly above its potential growth; Panel Figure 1), narrowing the output gap to -0.2 percent. The unemployment rate remained steady around 6.3 percent—close to historic lows—with mild softening in vacancy postings (Text Figure). Growth was uneven across the bloc: Spain continued to outperform due to stronger domestic demand, while Germany only narrowly emerged from two years of contraction. High-frequency indicators suggest some growth moderation in early 2026, even before the start of the war.

Labor Market Conditions
(Percent; ratio)



Sources: Eurostat and IMF staff calculations.

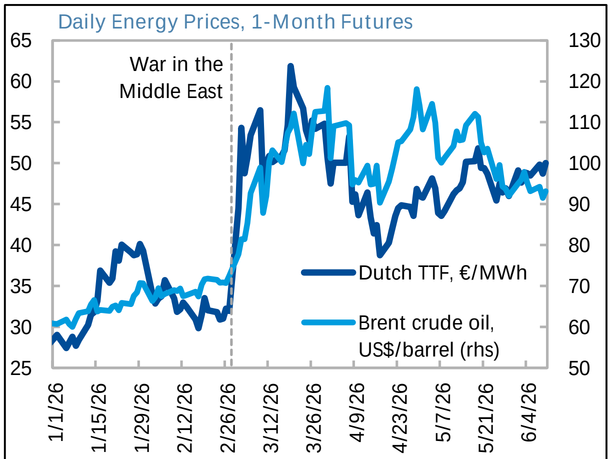
- *Domestic demand.* Consumption proved robust, supported by healthy household balance sheets, real income gains, and high labor market participation. Private investment benefited from improving financing conditions (Panel Figure 4).[1] Fiscal policy was broadly neutral, as a mild contractionary impulse from national budgets (0.1 percentage point of GDP improvement in the aggregate euro area structural primary balance (SPB)) was offset by support from the Recovery and Resilience Facility (RRF).



Sources: ECB; and IMF staff calculations.

- *Net exports* contributed negatively to growth, reflecting robust imports, a higher effective US tariff rate, euro appreciation (Text Figure),[2] and lower services exports. The drag would have been even larger without trade frontloading in anticipation of US tariffs, which contributed an estimated 0.15 percentage point to 2025 growth.[3]

4. Following the start of the war in the Middle East, oil, gas, and fertilizer prices spiked, raising inflation expectations and interest rates, leading to wider sovereign and corporate spreads. Disruptions in the Strait of Hormuz and damage to production facilities caused oil prices to rise past $100 per barrel at their peak (Text Figure). European prices of imported natural gas were also hit, with Dutch TTF prices surging by nearly 70 percent.



Sources: Bloomberg Financial, L.P.; and Intercontinental Exchange.

- Market-based inflation expectations jumped after the war started, with the 1y1y inflation linked swap increasing by 0.4 percentage point to 2.2 percent and the 5y5y increasing by 0.1 percentage point (as of early June). The slower-moving expectations from professional forecasters also rose, with Bloomberg's inflation survey of brokers increasing by 1.1 percentage point for 2026 and 0.3 percentage point for 2027 since the onset of the war.

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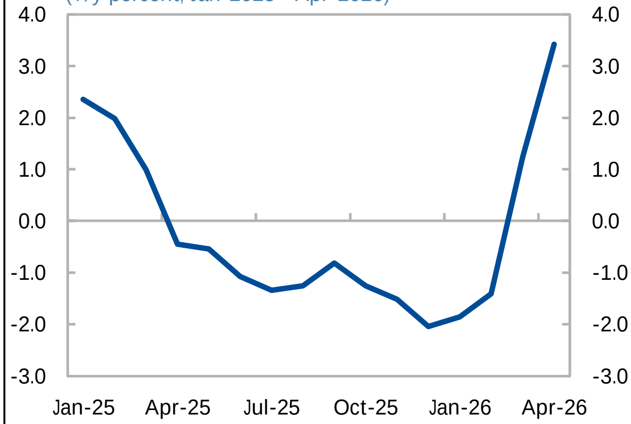
[1] Bank lending to non-financial corporations recovered from its trough in late 2023 to around 3 percent, year on-year at end-2025, above the pre-Covid average of 2.3 percent (2015-19).

[2] The nominal effective exchange rate (NEER) appreciated by around 6 percent between February and July 2025 and has remained broadly flat since then.

[3] Staff estimated a model for export demand that depends on foreign demand and exchange rate developments. The frontloading effects are calculated as the difference between actual and predicted values from the model.

5. Before the rise in inflation expectations, headline inflation had hovered within a narrow range around the 2 percent target since March 2025. During 2025, euro appreciation—and, to a much lesser extent, lower import prices from trade diversion—put downward pressure on goods inflation (Text Figure).[4] However, wage-sensitive inflation remained elevated, with upside surprises in Spain and Germany. Consistent with headline inflation returning to target in early 2025, the ECB Governing Council steadily reduced policy rates through June 2025, bringing the deposit facility rate to 2.0 percent in line with staff estimates of a neutral monetary policy stance.[5] In June 2026, it raised the policy rate by 25 basis points.

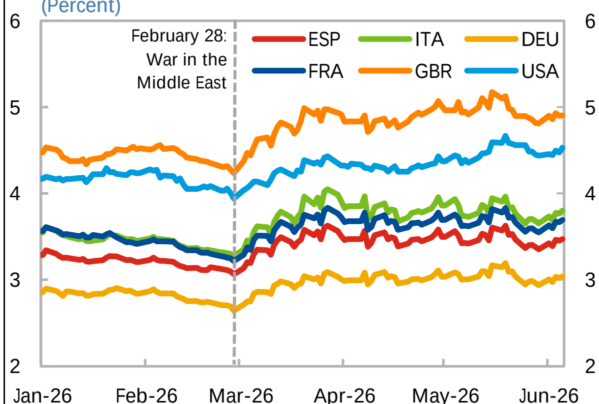
Manufacturing Import Prices Excl. Euro Area
(Y/y percent, Jan-2025 - Apr-2026)



Sources: Eurostat; and IMF staff calculations.

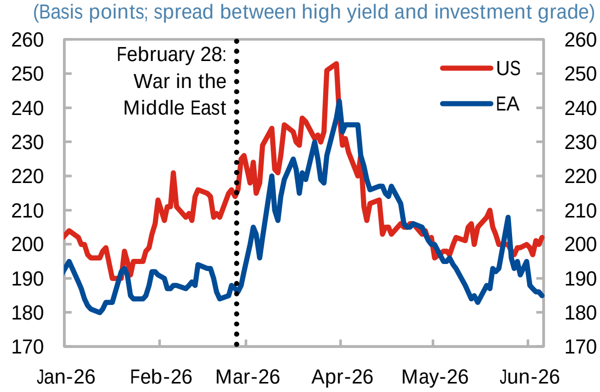
- The spike in energy prices triggered a moderate tightening in financial conditions, with higher sovereign yields and wider spreads. Since the start of the war, the German 10-year bund yield increased 40 basis points (as of early June), broadly in line with other major markets, while French, Italian, and Spanish sovereign spreads widened 0-15 basis points (Text Figures).

10-Year Government Bond Yields
(Percent)



Sources: Bloomberg Financial L.P.

Corporate Credit Risk Premia: US and EA
(Basis points; spread between high yield and investment grade)



Sources: Bloomberg Financial L.P.; ICE Data Indices; and IMF staff calculations.

6. The current account surplus narrowed markedly in 2025, falling to about €276 billion (1.7 percent of GDP) from €416 billion in 2024 (2.7 percent of GDP). The euro area's external position

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[4] According to staff analysis, the appreciation of the nominal effective exchange rate over the last year could have lowered the level of core prices in the euro area's largest four economies around 0.3 percentage point by 2026Q1. While China has been accounting for a growing share of euro area imports over the past decade, following the increase in US tariffs in 2025 so far there has been no meaningful acceleration in imports from China above the structural trend. China's penetration in EU imports is concentrated in a few sectors—miscellaneous manufactures, machinery and transport equipment, and other manufactured goods.

[5] Beyer and Brandao-Marquez (2025), "Real Equilibrium Interest Rates in the Euro Area," IMF Working Paper 25/123.

is assessed as broadly in line with the level implied by medium-term fundamentals and desirable policies (Table 2). The decline was driven mainly by a deterioration in the primary income and services balances. Net investment income weakened, with the primary income balance shifting from surplus to deficit, while the services surplus fell. The footprint of US multinationals in the euro area has contributed to both developments: profit outflows and lower net direct investment income weighed on the income balance, while royalty payments and other business service imports—particularly related to the use of intellectual property—reduced the services surplus. By contrast, the goods surplus edged up, supported in part by a continued decline in the energy trade deficit. The household saving rate remained elevated at around 15 percent, while a pickup in capital formation, including a marked acceleration in household (primarily housing) investment, narrowed the surplus.

7. The increase in US tariffs in 2025 and trade policy uncertainty have accelerated the EU's efforts to diversify and deepen trade relations. The 2025 EU–US Turnberry trade agreement resulted in a 15-percent headline tariff ceiling on US imports and bilateral "zero-for-zero" tariff liberalization on selected strategic products, as well as investment and purchase agreements. The conclusion of trilogue negotiations in May 2026 paved the way for formal EU adoption by the end of June.[6] Meanwhile, the EU has advanced trade agreements with other trading partners. The EU–Mercosur Partnership, under provisional application since May 2026, is broad in scope, liberalizing tariffs and covering regulatory cooperation, services, intellectual property, subsidies rules, transparency, and procurement. It also includes state-to-state dispute settlement to reinforce legal certainty. The EU has concluded additional free trade agreements with Australia, India, and Indonesia, which now await signature and ratification, and initiated a dialogue with the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. While the direct GDP impact of these agreements is expected to be modest—particularly in the near to medium term—they are estimated to boost exports by about 6 percent and support greater trade diversification.

OUTLOOK AND RISKS

8. The war in the Middle East is expected to represent a large but temporary adverse supply shock to the euro area (Text Table 1). Before the energy price shock, activity in 2026-27 was expected to continue expanding at a steady pace. Higher energy prices are now projected to reduce growth by 0.5 and 0.2 percentage point in 2026 and 2027, respectively.[7] Private consumption is forecast to decelerate on higher energy prices and lower real disposable income, though healthy household balance sheets provide some offset. Private investment is also projected to decelerate

[6] The February Supreme Court ruling, rollback of tariffs imposed under IEEPA, and subsequent imposition of temporary Section 122 tariffs have left the US effective tariff rate on EU imports broadly unchanged at around 11.4 percent. On June 2, USTR proposed additional tariffs on 60 countries following its conclusion of Section 301 investigations into the failure to impose or effectively enforce prohibitions on importation of goods produced with forced labor practices. The 10 percent or 12.5 percent tariffs are expected to have a limited impact on the effective tariff rates for affected economies, as the measures would effectively replace the 10 percent Section 122 tariffs. Additional changes to tariffs on steel and aluminum derivative products and structural excess capacity and over-production in manufacturing sectors–both of which include the EU–are also expected.

[7] Recent changes to US tariffs have left the US effective tariff rate of imports from the EU broadly unchanged. Assumptions on defense and infrastructure spending remain largely unchanged from April WEO.

because of higher input costs and protracted uncertainty, while defense and infrastructure spending (already incorporated in the pre-war baseline projection, with most of it originating in Germany) are expected to remain largely unaffected. The external contribution is expected to remain broadly unchanged, as higher import prices (caused by the energy shock) slow imports and weaker external demand slow exports by a similar magnitude.

Text Table 1. Euro Area Forecast

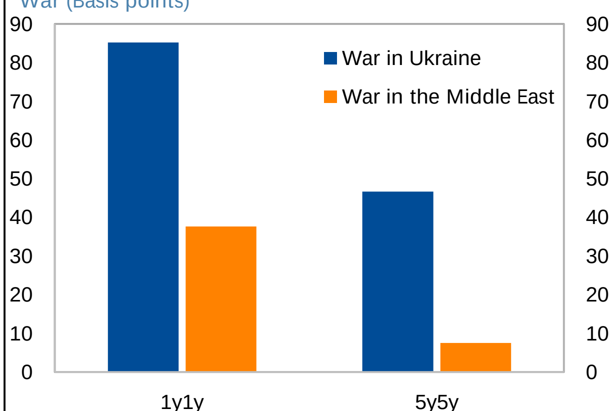
	Growth		Headline inflation		Core inflation	
	2026	2027	2026	2027	2026	2027
Jan 2026 WEO forecast (percent)	1.3	1.4	1.9	2.0	2.2	2.0
Mechanical revision from stronger-than-expected 2025 outturn	+0.1	0.0	+0.1	-0.1	-0.1	0.0
Change mostly due to war in Middle East (pp)	-0.5	-0.2	+0.9	+0.4	+0.2	+0.3
July 2026 WEO forecast (percent)	0.9	1.2	2.9	2.3	2.3	2.3

Sources: IMF WEO; and IMF staff calculations.

Note: Projections for 2026-2031 are based on July WEO 2026 projections of France, Germany, Ireland, Italy, Netherlands, and Spain (accounting for around 85% of EA GDP) and April 2026 WEO projections for others.

9. Under the baseline, inflation is forecast to rise above target during 2026–2027. The surge in energy prices is expected to lift headline inflation (Text Table 1), with some effects on near-term inflation expectations and wage growth. Consequently, core inflation is expected to average 2.3 percent during 2026 and 2027. As of early June, near-term inflation expectations have risen by 40 basis points, while long-term expectations have remained stable. The more muted response of inflation expectations to the energy shock compared to the experience following the start of the war in Ukraine (Text Figure) partly reflects a smaller impact on gas and hence electricity prices, changes in the energy mix toward more renewables, and better energy infrastructure that reduce pass-through from oil and gas prices to wholesale energy prices, as well as different starting positions of the economy, including a less tight labor market and a small negative output gap. Moreover, energy inflation is projected to turn negative in early 2027, helping to bring inflation back to target over the medium term.

Change in Inflation Expectations, 100 Days After Start of War (Basis points)



Sources: LSEG Datastream; and IMF staff calculations.

10. The monetary policy rate is expected to increase over 2026, while fiscal policy is assumed to be broadly neutral.

- The baseline assumes another 25 basis points increase in the ECB policy rate to 2.5 percent by the end of 2026.[8]
- The average euro area structural primary balance (SPB) is projected to remain broadly stable in the near term with a marginal decline from -1.4 percent of GDP in 2025 to -1.5 percent of GDP in 2026, as Germany's ramp-up in defense and infrastructure investment is largely offset by consolidation in countries with high debt levels, including France and Italy. The use of the RRF is expected to continue providing support, as around €100 billion (0.5 percent of EU GDP) in grants are available through August 2026, subject to member states' implementation capacity.

11. Over the medium term, only limited fiscal adjustment is expected. The SPB is projected to improve gradually from -1.5 percent of GDP in 2027 to -0.9 percent of GDP in 2031, as rising defense spending undercuts projected fiscal consolidation. Defense spending is expected to rise from 2 percent of GDP in 2025 to 2.4 percent of GDP in 2031 at the euro area aggregate level (incorporating measures that are sufficiently detailed and have identifiable budgetary impact), with varying implications for growth, inflation, public debt, and external balances that depend on financing choices, spending types, and import content.[9] Nevertheless, given the elevated deficit levels (compared to a surplus of around 0.9 percent of GDP in 2019), public debt is projected to continue rising from 83 percent of GDP in 2019 and 87 percent in 2025 to about 90 percent by 2031. General government debt is expected to rise in most countries—notably in France and Germany—but fall in a handful of countries including Greece, Portugal, and Spain.

12. However, activity and inflation could evolve along different paths, depending on how quickly energy market disruptions ease and are transmitted through the economy (Text Table 2). The aggregate demand response could be more severe than in the baseline if financial stress (that is, higher sovereign risk premia, rising corporate spreads and bankruptcies, or more non-performing loans and credit) or weak confidence weighs significantly on consumption and investment. In that case, the negative output gap could widen significantly, dampening the effect of rising energy prices on inflation (Text Table 2, top right). Alternatively, a larger or more persistent increase in energy prices and/or severe shortages could lift headline inflation persistently above target, with larger effects on medium-term inflation expectations, but not necessarily triggering additional negative demand amplifications because of financial stress (Text Table 2, bottom left). Finally, persistent energy price increases alongside stronger demand amplification from financial stress, could sharply raise inflation expectations and widen the negative output gap (Text Table 2, bottom right).

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[8] The assumption is based on information available as of early June: markets were pricing in two 25 basis point hikes over the course of 2026 and attaching around 50 percent probability to a third hike.

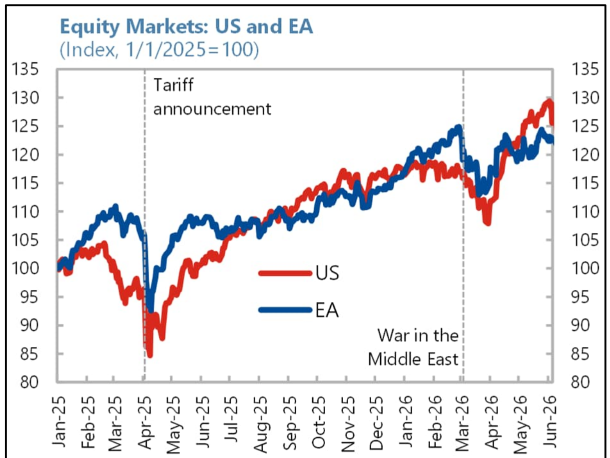
[9] Defense spending increases could support near-term growth but often accompanied by higher inflation, rising debt, and a deterioration in external balances, when spending is deficit-financed, concentrated in current outlays, or highly import-intensive. Growth effects tend to be larger and more persistent when spending is investment focused and implemented under favorable financing conditions, and can generate sizable cross-border spillovers within the EU (IMF, *World Economic Outlook,* April 2026, Chapter 2; Furceri and others (2026), "Macroeconomic Impact of EU Defense Spending," IMF Working Paper 26/53).

Text Table 2. Baseline and Alternative States of the Economy		
	Small demand amplification response	Large demand amplification response with financial stress
Baseline energy shock	Headline inflation is projected to rise temporarily, with medium-term inflation expectations broadly anchored at target and a small negative output gap.	Headline inflation is projected to rise modestly and temporarily, with medium-term inflation expectations remaining anchored at target and a wider negative output gap.
More severe energy shock and/or large supply disruptions	Persistent increase in headline inflation, with medium-term inflation expectations above target and a small negative output gap.	Persistent increase in headline inflation, with medium-term inflation expectations above target and a wider negative output gap.

13. On balance, the risks are skewed toward lower growth and higher inflation. The largest risk is the extent of energy market disruption because of the war in the Middle East. A slower (faster) restoration of global energy supply would dampen growth and raise inflation more (less). Rationing and severe shortages of goods associated with the war could amplify the impact on activity. Further intensification of the war in Ukraine, or renewed disruptions and uncertainty from tariffs and trade policies could weigh on activity more strongly or for longer than expected. A sharp global market correction, e.g., triggered by underperformance of AI investment, could lower growth. On the upside, faster-than expected AI investment and deployment as well as a resolution of the war in Ukraine could lift growth above the baseline. Inflation could be higher than expected if renewed wage pressure lifts services inflation, or rising defense and infrastructure investment in the EU collides against supply bottlenecks.

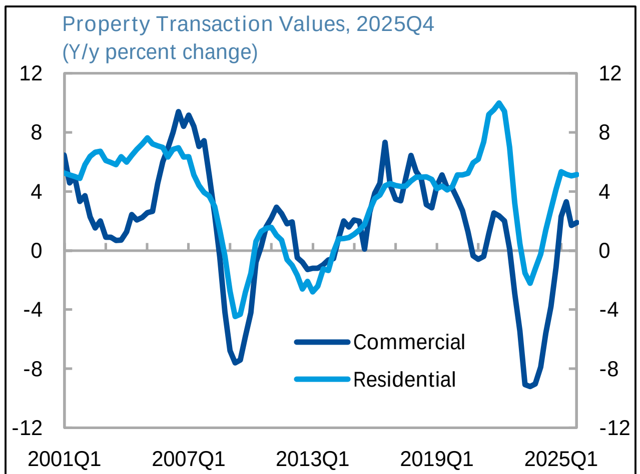
14. The euro area is expected to maintain external balance over the medium term, though there are risks. Over the medium term, the current account is projected to gradually rise as the temporary drag from the energy shock dissipates. Other factors are expected to limit the increase (to 1.8 percent of GDP). Germany's fiscal expansion is projected to lift domestic spending and strengthen euro area demand, while structural reforms implementation across the euro area could facilitate higher private investment. These factors bolster external stability, with favorable global spillovers. However, delayed fiscal consolidation in high-debt countries could lead to a sharper and more disruptive fiscal correction over the medium term, causing negative spillovers for trading partners and external investors, especially if weaknesses in the euro area's crisis management framework are exposed.

15. Systemic financial stability risks have risen since the 2025 Annual Consultation, following the energy price shock. While financial conditions have since eased from their post-shock peaks (Panel Figure 4), uncertainty remains elevated and three key risks stand out.



Sources: Bloomberg Financial, L.P.; and IMF staff calculations.

- First, a sharp deterioration in global financial sentiment—triggered, for instance, by a disorderly repricing of AI-related assets (following a reassessment of expected productivity gains) or by renewed bond market stress—could abruptly tighten financial conditions. Stretched equity valuations, high public debt, and a more price-sensitive sovereign investor base in the euro area could amplify repricing pressures (Text Figure). Spillovers could come through valuation losses for euro area banks and nonbank financial institutions (NBFIs), particularly those with concentrated US exposures. They could also come from liquidity pressures in the NBFI sector and disruptions in core funding markets. Stress could be magnified by disruptions in US dollar funding, given euro area banks' reliance on short-term wholesale USD funding and their role in intermediating US dollar liquidity particularly through repo markets (sitting between US-based money market funds and internationally active hedge funds that rely on repo leverage).

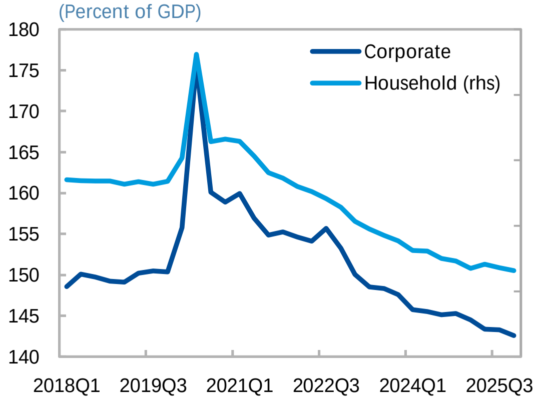


Sources: ECB; and IMF staff calculations.

- Second, stress in leveraged and opaque segments of the NBFI sector—including investment funds with commercial real estate exposures, real estate investment trusts, and private credit—could propagate to banks and core funding markets (Text Figure). Rapid NBFI balance-sheet growth, limited price discovery, and leverage in some strategies can intensify redemption pressure and fire-sale dynamics. Moreover, bank–NBFI interconnections (loans, securities holdings, off-balance-sheet exposures, derivatives, and securities financing transactions) can transmit losses, while redemption pressures and margin/collateral calls can force asset sales that spill into sovereign and funding markets.

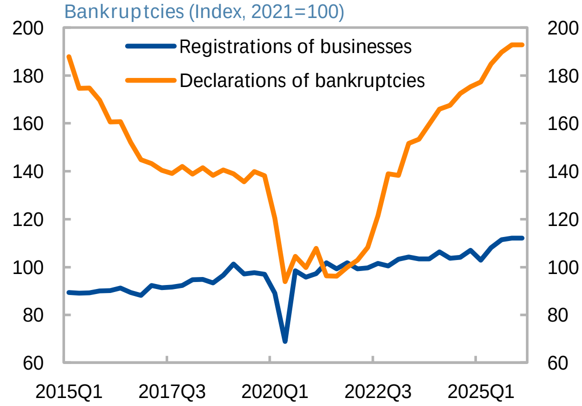
- Finally, weaker growth could impair borrower performance and tighten credit supply through adverse macro-financial feedback loops, weighing further on investment (the April 2026 Bank Lending Survey indicates that borrowing conditions for euro area small and medium-sized enterprises have tightened). However, a faster normalization of energy and other input prices could mitigate these risks, alongside other supporting factors. Corporate balance sheets remain healthy in aggregate, notwithstanding a recent uptick in bankruptcies (Text Figures). Residential real estate risks also appear to be contained at the euro area level, despite continued price pressures in some member states (e.g., Bulgaria, Croatia, Cyprus, Greece, Ireland, Portugal, Lithuania, and Spain). Euro area banks are resilient in aggregate, supported by robust capital and liquidity buffers, low NPL ratios (Text Figure), and rising profits as maturing loans reprice at higher interest rates.

Corporate and Household Debt
(Percent of GDP)



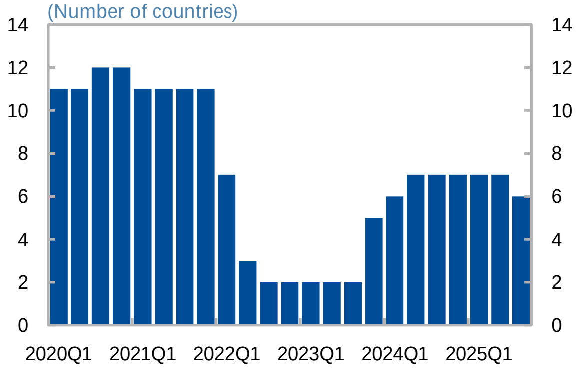
Sources: Eurostat; and Haver Analytics.

European Union Businesses' Registrations and Bankruptcies (Index, 2021=100)



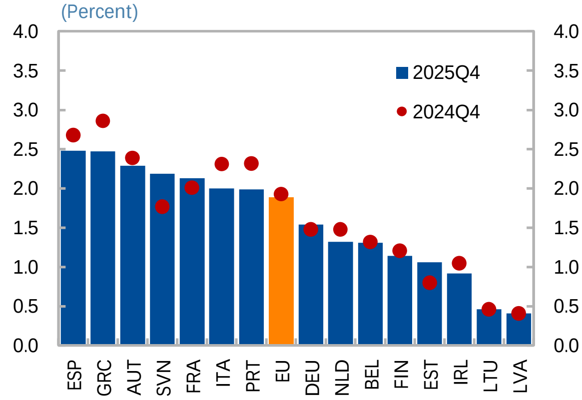
Source: Eurostat.

Euro Area Countries in Housing Boom
(Number of countries)



Source: IMF staff calculation based on Albuquerque and others (2026).

Non Performing Loans Ratio
(Percent)



Sources: ECB; Eurostat; Haver Analytics; and IMF staff calculations.

Authorities' Views[10]

16. The authorities underscored elevated uncertainty surrounding the range of possible outcomes from the current war in the Middle East and supplemented baseline projections with alternative scenarios incorporating more adverse energy price paths and larger pass-through to other prices. The authorities emphasized that the current shock differs from the 2022 episode in several key respects: it is global rather than Europe-specific, the energy price shock is smaller and driven more by oil prices than gas prices and hitting the economy at a different cyclical juncture—with no strong pent-up demand like after the post-pandemic reopening, policy rates in a broadly neutral range, inflation close to target, and longer term inflation expectations well anchored. Even

[10] The term "authorities" refers to regional institutions responsible for common policies in the currency union and not to the respective member states' authorities, unless specifically identified by the country's name.

after growth downgrades and upward revisions to inflation over the spring, the authorities assess risks tilted to the downside for growth and to the upside for inflation. Oil and gas prices entail further upside risks, with additional threats from potential supply-chain disruptions and supply constraints in related markets (e.g., fertilizers and helium). Alternative scenarios incorporate non-linearities in case of higher alternative paths for energy commodity prices, implying stronger indirect and second-round effects on euro area inflation than in the baseline projections.

17. The authorities assessed financial stability and geopolitical risks as elevated. They emphasized that structural changes in bond markets—including the growing presence of NBFIs—and increased equity market concentration in the US (to which euro area investors are highly exposed) have heightened price sensitivity, raising the risk of abrupt repricing. Banks are well capitalized, have ample liquidity, and robust profitability. Corporate balance sheets were viewed as broadly sound, with the recent uptick in corporate bankruptcies so far seen as a normalization toward historical norms. The authorities are closely monitoring the rapid growth of private credit (which they viewed as smaller than in the US), focusing on banks' ability to identify aggregate exposures and counterparty risks. The authorities also emphasized that operational risks, particularly cybersecurity threats associated with advanced AI models, underscore the importance of rapid patching, preparedness, and effective implementation of the Digital Operational Resilience Act (DORA), while noting that no regulatory changes were currently needed.

MACROECONOMIC STABILIZATION POLICIES

Macroeconomic stabilization policies must be carefully calibrated within the available policy space and well communicated to smooth adjustment, while ensuring that necessary structural transformation continues. Assessing the severity of energy supply disruptions, as well as how strongly it is expected to amplify via financial conditions and aggregate demand, will be critical to guiding a state-contingent policy response. While the recommended policy mix may weigh on domestic demand in the near term, together with structural reforms it will support a durable recovery, preserve external balance, and yield positive global spillovers in the medium term.

A. Maintaining Price Stability

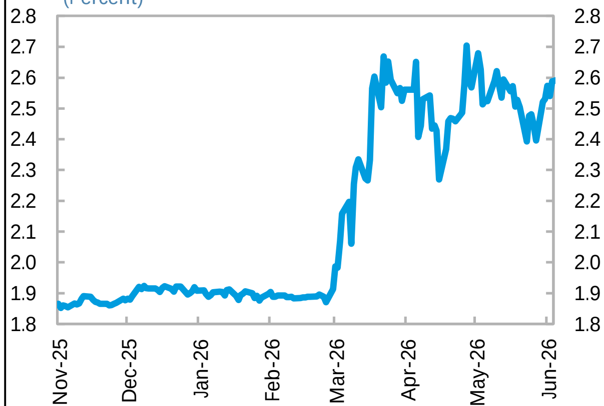
18. The policy rate will need to rise further to keep the impact of the shock on inflation contained. The economy's starting position before the war in the Middle East (¶3) had a broadly closed output gap, inflation fluctuating around target for about a year, medium-term inflation expectations firmly anchored at target, and the policy rate appropriately at a neutral level, where it neither restricted nor stimulated activity. The large increase in energy prices and headline inflation since the start of the war, along with the significant impact on near-term inflation expectations, suggests broader price pressures over the remainder of 2026 and into 2027. In the baseline, which assumes a cumulative 50 basis points increase in the policy rate in 2026 (¶10), this is reflected in an increase in core inflation (¶9). Headline inflation is projected to return to target only by the second half of 2028, with upside risks (¶13). Staff analysis suggests that the ECB hike of 25 basis points in June was appropriate and a further cumulative 50 basis points policy rate hike in 2026 would be

needed to ensure that medium-term inflation expectations remain anchored, the energy cost shock does not lead to generalized price increases, and inflation returns to 2 percent by end-2027. The interest rate path might need to be adjusted depending on evolving macroeconomic conditions (as discussed below in ¶28).[11]

19. The appropriate response beyond 2026 will depend on how the outlook evolves. A partial reversal of the 2026 hikes could become appropriate from mid-2027, conditional on energy inflation having turned negative, core inflation trending down, headline inflation converging firmly to target, and medium-term inflation expectations remaining anchored.

20. Clear communication and scenario analysis can help manage risks. Staff analysis shows that forward-looking communication is associated with lower market uncertainty about the future path of policy rates.[12] By focusing on the outlook, ECB communication has helped contain market uncertainty, despite the large increase in policy uncertainty. Until the start of the war in the Middle East, the €STR curve had remained largely unchanged in the preceding months, indicating that markets did not anticipate an imminent policy rate adjustment (Text Figure). The low variability in interest rate pricing during this period signaled strong confidence in the policy path. The rise in inflation uncertainty following the conflict strengthens the case for greater use of scenario analysis, as the ECB did with its March and June 2026 monetary policy decisions. By outlining alternative paths for inflation and the economy, such analysis can help reduce volatility in interest rate expectations by conveying the ECB's assessment of current risks and clarifying its reaction function. The ECB Governing Council should continue articulating resolve to prevent inflation expectations from de-anchoring and communicating its readiness to act quickly if necessary.[13]

€STR 6M, 1-Month Forward
(Percent)



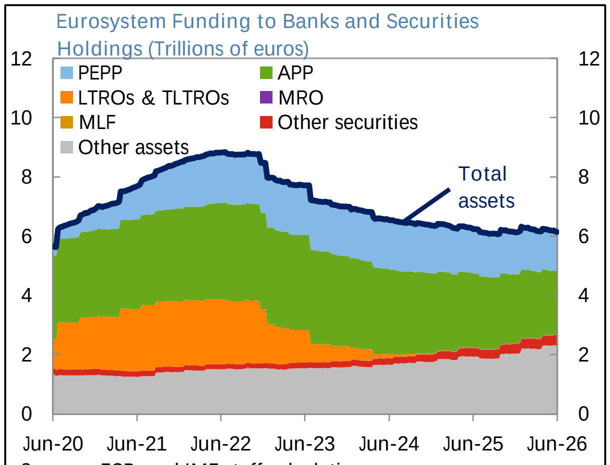
Source: Bloomberg Financial, L.P.

[11] Staff's recommendation is based on an estimated open economy standard DSGE model for the euro area in which the optimal policy path is derived as a function of staff's projection of the output gap, inflation deviation from target, and an interest rate smoothing parameter. For details on the model structure and properties, see Dizioli (2025), "Interest Rate Sensitivity Scenarios to Guide Monetary Policy," IMF Working Paper 25/107.

[12] Caselli and others (forthcoming), "Central Bank Communication in Times of Uncertainty: AI-assisted Decoding of Recent Trends in Europe," IMF Working Paper.

[13] Dizioli (2025), "Interest Rate Sensitivity Scenarios to Guide Monetary Policy," IMF Working Paper 25/107.

21. Although liquidity is expected to remain abundant for a while, the ECB should continue to prepare for the transition to its new operational framework. As the balance sheet continues to normalize (Text Figure), the focus should shift toward ensuring a smooth move to the new operational framework with ample—but not abundant—reserves. Although reserve volumes are not expected to bind for interest rate control this year, they may nevertheless begin to influence bank and bond market liquidity conditions in advance.[14]



Sources: ECB; and IMF staff calculations.

B. Ensuring Fiscal Sustainability Under Rising Spending Pressures

22. **Fiscal policy should support adjustment to the energy shock, while remaining prudent.** This requires preserving energy price signals and avoiding measures that would complicate monetary policy efforts to achieve price stability.

- Under the baseline forecast, policy makers should allow automatic stabilizers to operate to help cushion the impact on the economy, while offsetting their fiscal impact where space is constrained. Countries with high debt levels should adhere to their pre-war adjustment plans to safeguard medium-term sustainability. Should the outlook deteriorate significantly, fiscal policy may need to adjust (¶28).
- Many member states, however, have already introduced support measures—most commonly excise tax cuts and partial limits on price pass-through—estimated at around 0.1 percent of GDP (EU GDP-weighted average as of May 2026).[15] While largely intended as temporary, most measures have been broad based and likely blunt price signals. They should be unwound as intended, and pressures to expand them should be resisted given their fiscal cost and distortionary effects.
- The temporary relaxation of state-aid rules to support firms facing higher energy costs (Middle East Crisis Temporary State Aid Framework) must be monitored closely to ensure that implementation across member states preserves incentives for firms to adjust their energy mix.

[14] Brandao-Marques and Ratnovski (2024), "The ECB's Future Monetary Policy Operational Framework—Corridor or Floor?" IMF Working Paper 24/56.

[15] Based on GDP-weighted aggregation of country-level estimates compiled through the IMF-EUR Policy Tracker on Energy Support Measures. The scale so far is much smaller than during the previous crisis, when energy-related support across Europe averaged around 2.6 percent of GDP over 2022-23 (in GDP-weighted terms), relying predominantly on broad-based price measures (even though more targeted transfers to compensate the bottom 40 percent of households from the surge in the cost of living would have cost less than 1 percent of GDP). See Arregui and others (2022), "Targeted, Implementable, and Practical Energy Relief Measures for Households in Europe," IMF Working Paper 22/262.

- Some member states have introduced or are actively considering windfall taxes on energy companies to finance energy support measures, and some have called on the Commission to develop a coordinated EU-wide framework. Although windfall taxes could redistribute part of the war-induced windfall gains from energy producers to consumers, governments may already capture a share of these gains through higher VAT and excise revenues during energy price spikes, which can be used to fund targeted support. Moreover, given that a similar tax was used in 2022, repeated reliance on ad-hoc windfall taxes risks adding complexity and policy uncertainty, weighing on investment incentives in the energy sector.
- The Commission has proposed that countries reduce electricity taxes and levies, in support of electrification. Lowering above-minimum excise duties and removing non-energy-related levies can be justified where charges are weakly related to power sector costs. However, a permanent cut in electricity VAT below the standard rate applied to most goods and services is likely to be a blunt, costly instrument with limited impact on electrification decisions.

23. **Addressing fast-approaching long-term spending pressures requires a substantial fiscal effort, differentiated across countries.** For euro area countries excluding Germany, at the aggregate level, staff recommends a cumulative improvement in the SPB of about 3 percentage points of GDP between 2025 and 2031, requiring an additional adjustment of 1.7 percentage points relative to the baseline, concentrated in high-debt countries. This adjustment would place debt on a downward trajectory, reaching around 95 percent of GDP by 2031, compared to about 100 percent of GDP under the baseline. In some high-debt countries, front-loaded adjustment could help mitigate risks and bolster confidence. Germany has room to temporarily accommodate higher spending on defense and public infrastructure, followed by a gradual fiscal adjustment. Across countries, maintaining fiscal credibility is critical, as market conditions can shift abruptly, especially with the growing presence of price-sensitive investors.

24. **In many countries, the recommended adjustment calls for a comprehensive, growth-friendly consolidation, anchored in a credible medium-term framework.** This will require a combination of growth-enhancing structural reforms, pension reforms, and fiscal consolidation. Consolidation should prioritize measures that minimize adverse impact on growth—such as rationalizing current spending and transfers and reducing distortive subsidies and tax expenditures—while safeguarding productive public investment. Strengthening public spending efficiency through more rigorous public investment appraisal and selection, greater use of joint procurement, performance-based budgeting, and regular spending reviews can help deliver durable savings.[16] However, in some high-debt countries, this may entail hard choices, such as recalibrating aspects of the social model.[17] Stronger EU-level coordination in areas such as energy infrastructure investments (¶33) and joint defense procurement (¶53) can help contain costs and leverage efficiency gains.

25. **Strengthening implementation of the EU fiscal framework is the priority.** Calculating the framework's single operational indicator—the net primary expenditure growth—has proved

[16] IMF (2025), *Fiscal Monitor*, October.

[17] IMF (2025), *Regional Economic Outlook: Europe,* November, Chapter 1.

challenging, with ambiguity around the treatment of one-off and discretionary revenue measures. This points to scope for further guidance to ensure consistent application across member states. Anchoring the net expenditure path firmly in domestic budgetary processes will help improve the framework's effectiveness. More broadly, delivering on the framework's debt sustainability objective hinges on addressing deviations early on. Further enhancing transparency—including through rigorous scrutiny of macro-financial assumptions, publication of sensitivity analysis, and close monitoring of emerging risks using draft budgetary plans and annual progress reports—can enable early identification of potential deviations and timely course correction.

26. **The national escape clause risks delaying adjustment and placing debt on a permanently higher trajectory, requiring close monitoring and proactive planning.** For the countries that have activated the escape clause, staff analysis suggests that this flexibility, together with the deviations the framework permits under the control account, delays adjustment to the next planning period, where required adjustment could roughly double, exceeding 1 percentage point per year in some cases—demanding by historical standards. Even then, debt would resume declining only along a permanently higher path than the one envisaged in the current plans. The escape clause should, therefore, be used to support the initial phase of scaling up defense investment, not to finance recurring spending over extended periods. The Commission should systematically track cumulative deviations and regularly assess the implied adjustment needs for the next planning period. Where implied future adjustment needs appear demanding, the framework should facilitate gradual consolidation even while the escape clause is in effect, rather than postponing the full burden to the next planning period. As discussions advance on broadening the scope of the escape clause to include energy transition-related measures, any expansion should tightly circumscribe what qualifies for exemption and avoid further relaxation of the fiscal framework.[18]

C. Pursuing a Contingent Policy Approach

27. **Effective policy relies on identifying which state of the economy is likely to be materializing.** High-frequency indicators can help assess whether the baseline remains the most relevant benchmark, or whether conditions are departing into alternative states (Text Table 1). Alongside oil and gas futures curves, policymakers need to monitor the extent to which the increase in energy prices since the start of the war in the Middle East are feeding into medium-term inflation expectations and core inflation through forward-looking indicators of wage- and price-setting behavior, including wage trackers and surveys of firms' selling price expectations.[19] At the same time, high frequency indicators such as market bid-ask spreads, credit risk premia, lending standards, and survey-based measures of business and consumer sentiment can help assess the extent of macro-financial amplification and monetary policy transmission.

[18] In its 2026 European Semester Spring Package, the Commission proposed new limited fiscal flexibility for energy resilience measures with an annual cap of 0.3 percent of GDP (cumulatively 0.6 percent of GDP through 2028). Eligible energy measures include support to households and firms that lowers fossil fuel dependency, measures that accelerate electrification, and investments in grids, storage, or clean energy sources.

[19] Lane (2026), Remarks at The ECB and Its Watchers XXIV Conference, panel on "Monetary Policy Amidst Trade Shock, Rising Debt and Diverse Drivers of Inflation," March 25.

28. Should the outlook depart markedly from the baseline forecast, the policy response would need to adjust.

- If energy prices and inflation expectations rise further than would be consistent with the inflation path envisaged under the baseline forecast, faster and/or larger tightening might be appropriate. However, if the increase in inflation expectations is paired with substantial deterioration in financial conditions and lower demand, a more negative output gap would limit inflation pressures and reduce tightening needs. If energy prices and inflation expectations moderate more quickly than consistent with the baseline, less tightening may be warranted.
- Any extension of existing measures or new measures, if warranted, should be well-targeted, temporary, and preserve prices signals to facilitate energy demand adjustment and avoid adverse spillovers to other energy-importing economies. Broad-based measures should be avoided—as they are fiscally costly and could necessitate a more forceful monetary policy response to limit second-round effects. Any support for firms, including via state aid, should be temporary, targeted to otherwise viable, energy-intensive firms, conditioned on energy-efficiency improvements, and coordinated at the EU level to limit single-market distortions. Overall, such support should be limited, given firms' greater capacity to adjust and the difficulty of identifying viable beneficiaries ex ante. Scaling up discretionary support would weaken fiscal balances and raise public debt, with possible market reassessment of fiscal risks further increasing sovereign borrowing costs. Where fiscal space is constrained, support should be at least partially offset to prevent deficit slippage and contain debt risks.
- As part of its standard toolkit to address potential stress, the ECB should remain ready to provide liquidity to safeguard smooth market functioning. Emergency Liquidity Assistance (ELA) as described in the ELA Agreement could be provided by national central banks with ECB coordination if solvent banks face temporary liquidity pressures. The ECB should continue to be prepared to deploy USD liquidity through existing facilities or, if needed, bilateral arrangements with the Federal Reserve and other major central banks to address funding pressures in cross-border credit intermediation. Where credit provision to the real economy is impaired and buffers have been built up, releasable capital buffers should be released to absorb losses and prevent a credit crunch, closely coordinated with supervisory actions. In the event of systemic NBFI liquidity pressures, support should be delivered through bank-intermediated liquidity with NCBs extending emergency liquidity assistance to NBFIs where legally and operationally feasible, in coordination with the ECB. Monitoring of bank–NBFI linkages and market-based vulnerabilities should be intensified amid tighter financial conditions.

Authorities' Views

29. The ECB reaffirmed its data-dependent, meeting-by-meeting approach to monetary policy. Despite well-anchored medium-term inflation expectations, the recent rise in short-term inflation expectations deserves close monitoring. The Governing Council increased its key interest rates on 11 June in line with its commitment to setting monetary policy to ensure that inflation stabilizes at its two per cent target in the medium term. Its decisions will be guided by the evolving inflation outlook and the risks surrounding it, underlying dynamics, and the strength of policy

transmission, without pre-committing to a specific rate path. The authorities stressed that the longer the conflict persists, the stronger is the likely impact on broader inflation and the economy. The authorities also reaffirmed the continuation of balance sheet contraction. The APP and PEPP portfolios are declining in a gradual, and predictable manner, with realized effects on long-term rates as expected.

30. The Commission emphasized that fiscal support in response to the energy price shock should mainly rely on automatic stabilizers, while keeping discretionary measures limited. They did not see a need to offset the impact of automatic stabilizers, consistent with the EU fiscal framework's design, but agreed that energy-related measures should remain temporary, well targeted to vulnerable households, and preserve price signals. The authorities noted the growing pressures to expand or extend such measures as energy price increases persist, which would further weigh on strained public finances.

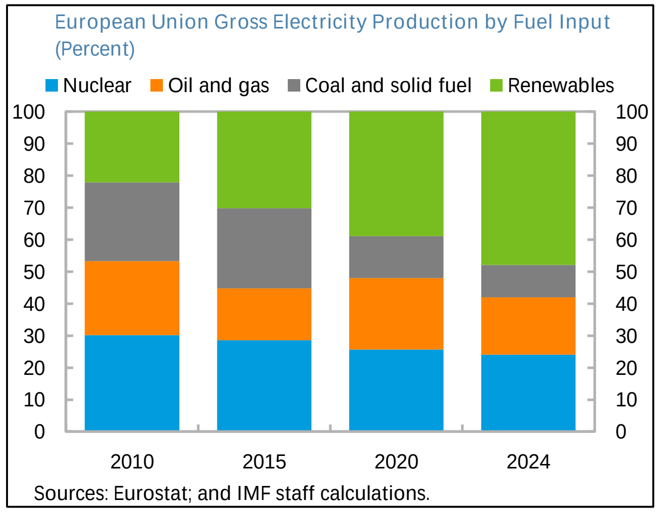
31. The authorities stressed that maintaining medium-term fiscal adjustment and effective implementation of the EU fiscal framework remain essential. They concurred that member states should implement their agreed adjustment paths under the MTFSPs but cautioned that materially more ambitious adjustment could prove difficult. They stressed that a timely and credible exit from the escape clause is important. The authorities noted that, although the definition of the net expenditure concept is clear in legislation, its implementation can be technically complex underscoring the need for transparency and consistent application.

ENHANCING RESILIENCE AND MEDIUM-TERM GROWTH

Despite progress since 2022, vulnerabilities arising from global energy markets remain high, underscoring the need to advance the energy transition and energy market integration. More broadly, rising geoeconomic fragmentation and external supply risks highlight the importance of a disciplined approach to strengthen resilience. At the same time, EU-level and complementary national reforms to deepen the single market and strengthen innovation are essential to boost growth and resilience, including by easing financing constraints, facilitating firm scale-up, and strengthening private investment. Over the medium term, a sustained pickup in private investment would support a broadly balanced external position, particularly as several countries face the need for fiscal consolidation. Stronger EU-level fiscal coordination can help reinforce both resilience and productive capacity.

A. Boosting Energy Security

32. The current energy shock renews the urgency to persevere with Europe’s energy transition and further integrate EU energy markets. The region is better prepared today than in 2022, reflecting lower energy consumption, higher share of renewables (Text Figure), and



infrastructure improvements.[20] Since 2021, import volumes of natural gas (combined amounts of liquefied and in gaseous state) and of petroleum oils have dropped around 20 percent and around 5 percent, respectively.[21] While lower now, vulnerability to rising costs of imported fossil fuels remains. Even before the start of the war in the Middle East, European energy prices—notably natural gas and electricity for industry—were significantly above those in other major economies (around twice US levels and about 50 percent above Chinese levels in the case of electricity). The increases in oil and natural gas prices since then (¶4) highlight the urgent need to create an energy system that provides affordable, low-carbon energy while ensuring resilience and security of supply. To achieve this, better integrating EU electricity markets will be essential, because renewable energy potential is unevenly distributed across the EU.

33. Delivering the energy transition and scaling long-term energy infrastructure investment requires a comprehensive strategy and predictable climate policies.[22] The Commission's proposed Grids Package and plans to expand grid investment in the EU's next budget are welcome and could accelerate permitting and strengthen interconnections. Staff analysis finds that even low-price countries can gain from better interconnected grids, suggesting that political economy constraints can be overcome.[23] Europe would benefit from a comprehensive EU-level strategy that covers the entire energy system (beyond grid interconnection)—coordinating planning,

[20] Energy consumption is around 10 percent below the 2021 level, owing to conservation, efficiency gains, structural adjustment, and some relocation of energy-intensive industries outside the EU). Moreover, the share of renewables has increased (with a close to 10 percent increase in solar, wind, and hydro as a share of the overall energy mix). Staff analysis also finds that, without energy efficiency gains since 2021, the lasting damage to euro area GDP from the energy disruption after the war in Ukraine would have been two-thirds larger. See Georgieva (2026).

[21] See https://ec.europa.eu/eurostat/statistics-explained/index.php?title=EU_imports_of_energy_products_-_latest_developments. Also see https://ec.europa.eu/eurostat/web/products-eurostat-news/w/ddn-20260325-3.

[22] See Carton and others (2026), "The EU's Energy Transition," IMF Working Paper 26/46. The macroeconomic effects of the green transition in Europe are likely to remain contained with well-designed policies. The transition mainly reallocates investment from fossil-based activities to clean technologies, with total investment increasing by only around 1 percent of GDP, driven by higher green investment. Growth effects are moderate, with long-term aggregate output increasing slightly by about 0.2 percent, after an initial slowdown. Effects on inflation and public finances remain subdued, especially when carbon pricing revenues are effectively recycled. These revenues can be substantial, with emissions trading systems projected to generate up to about 1 percent of GDP, while required public investment remains below 0.5 percent of GDP.

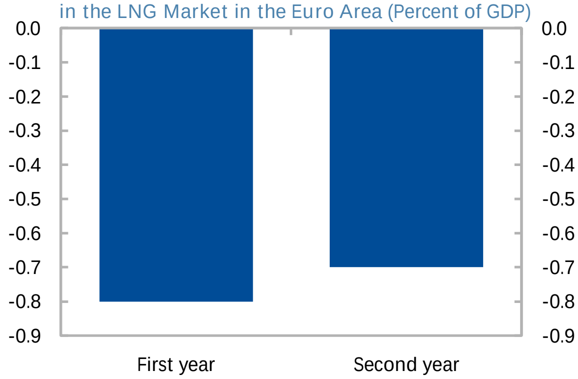
[23] On average, new EU interconnections reduce wholesale electricity prices by around 5 percent. Prices can fall on both sides of the interconnection since even countries with relatively low prices experience occasional spikes. Interconnections help smooth these fluctuations—effectively providing insurance. See Bartolini and others (forthcoming), "Energy Prices, Market Fragmentation, and the Macroeconomics of Energy Market Integration in Europe," IMF Departmental Paper.

investment, and market design across member states.[24] Within this framework, a stable and predictable EU ETS and launching ETS2 in 2028 remain essential. Weakening the ETS risks diluting the carbon pricing signal, reducing predictability for renewables' investment, and making it more costly to finance clean technologies when they are needed most. The temporary relaxation of state aid rules for energy-intensive firms in response to the war in the Middle East should remain limited in time and scope to avoid weakening energy transition incentives.

B. Addressing External Supply Risks

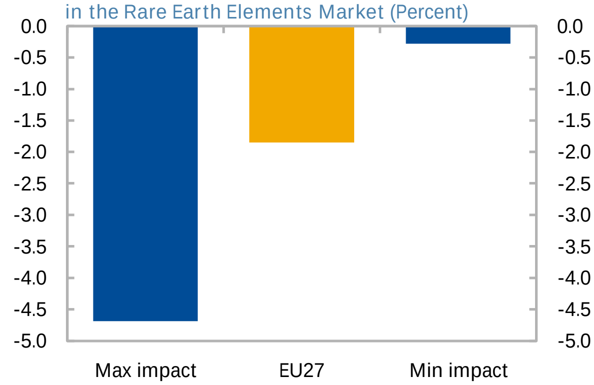
34. The euro area's deep integration into global value chains has been a source of prosperity but also implies significant exposures to external supply disruptions. Staff analysis suggests that—as evident during the supply bottlenecks in the aftermath of the pandemic—supply-chain disruptions in a small set of critical inputs can have an outsized macroeconomic effect. Costs are highest where external supply is highly concentrated, difficult to substitute in the short run, and central to production networks—allowing shocks to propagate well beyond the directly affected sectors. For example, model-based simulations suggest that a natural-gas price shock equal to half the post-Ukraine invasion surge could lower euro area GDP by about 0.8 percent in the first year, despite gas imports accounting for less than 0.1 percent of GDP. Rare earth elements (REEs) provide a complementary illustration: although their import value is similarly small, their supply is extremely concentrated—with about 95 percent sourced from three external suppliers—and demand is tightly linked to key manufacturing and technology-intensive sectors (such as automobiles, defense, renewable energy, and electronics). A disruption that abruptly reduces EU imports of REE by 50 percent could lower EU GDP by 1.8 percent, with impacts varying across countries depending on production structure and exposure (Text Figures). For example, countries with large motor vehicle sectors would be disproportionately affected by REE disruptions.

The Economic Impacts (GDP) of a Large Disruption in the LNG Market in the Euro Area (Percent of GDP)



Source: Dizioli, A., and R. Varghese (forthcoming), IMF Working Paper.

The Economic Impacts (GDP) of a Large Disruption in the Rare Earth Elements Market (Percent)



Source: Dizioli and Varghese (forthcoming), "To Act or Not to Act: Supply Chain Vulnerabilities and Government Intervention," IMF Working Paper.

[24] Countries often plan capacity mechanisms independently to ensure sufficient electricity supply in emergencies. Coordinating these mechanisms at the European level could generate significant efficiency gains.

35. Policies to enhance resilience to supply chain vulnerabilities call for a disciplined approach. Efforts to reduce exposures to external supply risks can provide valuable insurance, but they could be costly. A clear framework is needed to weigh resilience gains against fiscal and efficiency costs, and to guide intervention only where the balance clearly favors actions. Policy action should be anchored in a clear objective, be granular and targeted to clearly identify market failures, rely on the least distortionary instruments, and minimize spillovers.

36. The Industrial Accelerator Act (IAA) legislative proposal raises concerns, as its broad push to expand the EU's manufacturing base extends beyond mitigating external supply risks. The objective of increasing the manufacturing share from 14 percent to 20 percent of EU GDP by 2035 could lead to inefficiencies and industry protection, and lobbying pressures. Among the proposed measures, streamlining permitting and adopting an EU-level approach could strengthen resilience without sacrificing efficiency. However, other instruments—such as "made in EU" local content requirement in procurement and support schemes, as well as FDI conditions tied to local value creation in selected sectors—could distort sourcing and investment decisions, while not being well targeted at the vulnerabilities where resilience gains outweigh the efficiency and fiscal costs. They could also complicate trade relationships. Although the IAA acknowledges international procurement commitments, the test of WTO compliance and non-discrimination will ultimately lie in implementation.

37. Beyond external supply risks, EU-level industrial policies can help address persistent market failures but must be deployed cautiously. In the absence of comprehensive economy-wide carbon pricing, well-designed state aid can be a viable tool to support the renewables transition.[25] The Clean Industrial State Aid Framework (2025) provides the legal basis for member-state support for clean energy deployment, industrial decarbonization, and targeted electricity price relief for energy-intensive sectors.[26] However, targeted electricity price relief risks slowing structural adjustment if high energy prices prove persistent. To limit economic distortions, any industrial policy measures should address a clearly defined market failure, rely on the least distortionary instruments available, remain consistent with WTO principles to avoid exacerbating geoeconomic fragmentation, and should not undermine the integrity of the single market.[27] All interventions should therefore be temporary, proportionate, and coordinated at the EU level.

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[25] Baquie and others (2025), "Industrial Policies: Handle with Care," IMF Staff Discussion Note 2025/002.

[26] In 2023 member states reduced their state aid to 1.09 percent of GDP, down from 1. 4 percent in 2022. Spending is uneven across countries, ranging from 2.9 and 0.4 percent of national GDP (European Commission State Aid Scoreboard 2023, 2024).

[27] Brandao-Marques and Toprak (2024) find that while state aid increases employment and revenue of recipient firms, it has adverse spillovers to non-recipient firms in the same sector across the EU as it reduces their employment, revenue, and productivity. This suggests that state aid in practice distorts the playing field within the single market even though the EU State Aid control framework aims to govern the administration of state aid so that it does not undermine the single market.

C. Strengthening Growth and Resilience with Win-Win EU-Level Reforms

Deepening the EU Single Market

38. A deeper single market would deliver a clear growth–resilience dividend. Past integration has generated sizable income gains, yet remaining cross-border barriers in financial, labor, and energy markets indicate substantial additional gains if these obstacles are removed. These frictions prevent dynamic firms from scaling across the EU, weigh on productivity, and leave internal markets insufficiently diversified. Deepening the single market would both lift medium-term growth—by enabling scale, competition, and capital reallocation—and strengthen resilience by broadening internal risk sharing. Moreover, a sustained pickup in private investment and productivity following single market reforms would help preserve external balance over the medium term.

39. Unlocking these gains requires targeted EU-level action to ease the most binding constraints. Regulatory fragmentation, segmented financial markets, limited labor mobility, and incomplete energy market integration now weigh more heavily as external pressures mount.[28] Fragmented regulation raises the cost of operating across borders and slows the scaling-up of strategic industries that depend on EU-wide supply chains. Segmented capital markets restrict access to risk capital for innovative firms, leaving European savings in low-yield assets while dynamic firms seek financing abroad. Limited labor mobility constrains firms' access to talent and slows reallocation toward activities that are critical for Europe's economic resilience. Energy market fragmentation keeps prices high and volatile. A focused set of reforms across these areas can lead off deeper integration with meaningful payoffs.[29, 30]

40. Recent regulatory initiatives are a welcome step toward a more seamless single market, but more is needed. Deeper single market integration will require a concerted effort to eliminate national gold-plating, since regulatory add-ons and uneven enforcement of common EU rules remain a key source of fragmentation that undermines firm scale-up and private investment.

- Regulatory simplification and stronger enforcement of EU regulations can help bring in more private investment. The series of Omnibus packages initiated in 2025 and the Commission's new focus on strengthening the enforcement framework are therefore welcome.[31]
- Broader harmonization of national insolvency regimes remains critical to capital market integration and the effective functioning of the EU single market, by reducing legal

[28] IMF (2025), Euro Area Policies: 2025 Annual Consultation—Staff Report, IMF Country Report No. 25/174, July.

[29] Arnold and others (2025), "Lifting Binding Constraints on Growth in Europe: Actionable Priorities to Deepen the Single Market," IMF Working Paper 25/113.

[30] Staff analysis suggests that reducing intra-EU barriers to trade and labor mobility to US levels, together with closing domestic structural policy gaps to the global frontier, could raise EU productivity by slightly over 20 percent—eliminating about half the productivity gap with the US. See IMF (2025), *Regional Economic Outlook: Europe*, October.

[31] The Commission launched in January 2026 the first annual Single Market Enforcement Agenda, drawing on the Scoreboard's diagnostics and combining structured dialogue with member states and targeted infringement proceedings.

fragmentation and cross-border investment barriers. While the EU adopted a Directive in March 2026 harmonizing selected aspects of insolvency law, it does not establish common standards for the initiation of insolvency proceedings or a harmonized order of claims.

41. A voluntary 28th enterprise regime established through an EU regulation would materially lower legal fragmentation and facilitate firm scale-up across the single market. Staff estimates suggest that a comprehensive 28th regime could raise EU GDP meaningfully over the long run (Annex I). Importantly, by lowering cross-border regulatory uncertainty and providing more clarity to investors, it would improve the matching process across the EU—by connecting financial resources to entrepreneurial projects and linking entrepreneurs with suppliers and distributors—both essential for enabling dynamic firms to scale cross border. The Commission's proposal for an optional "EU Inc." is closely aligned with staff analysis, notably in its emphasis on a single legal form that ensures cross-border continuity, a digital-by-default entry point, and flexible capital structures suited to venture and growth financing. At the same time, key elements of a predictable, rescue-oriented insolvency framework remain underdeveloped, limiting the proposed 28th regime's ability to lower financing costs and support scale-up beyond early-stage firms.[32]

42. Providing finance for cross-border scale up and productive investment requires completing the savings and investments union (SIU).[33,34] Expanding the supply of long-term risk capital requires enabling greater participation by pension funds and insurers, improving retail investment vehicles, and strengthening exit options through more liquid public markets, while reductions in legal and tax-related barriers to cross-border investment could play a complementary role. Staff analysis indicates that reforms addressing key financial policy barriers could lift EU GDP by around 3 percent in the long run, driven mainly by easing cross-border banking frictions and complemented by a stronger supply of venture capital, with benefits accruing disproportionately to smaller economies and younger firms.[35] These gains would be amplified by a 28th regime (¶41), as firms scaling up across borders would generate greater demand for cross-border financial services. Deeper integration of public equity and bond market infrastructure and streamlining withholding-tax relief at source can mobilize savings at scale and lower the cost of capital, thereby further supporting private investment and external balance.

43. The benefits of a deeper single market would be amplified by greater issuance of EU safe assets. Over time, a more integrated capital market—together with progress on safe EU-level assets, including greater issuance at the EU level—would strengthen risk sharing in the euro area. In this regard, the ECB's recent enhancement of the Eurosystem repo facility (EUREP) to provide

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[32] Dizioli and others (forthcoming), "Toward a 28th European Enterprise Regime: A Single Rulebook to Enable Cross-Border Scale-Up in Europe," IMF Departmental Paper.

[33] Brandao-Marques and others (2026), "Deeper Financial Integration to Foster Growth and Resilience in Europe," IMF Staff Discussion Note 2026/002.

[34] Arnold and others (2025), "Lifting Binding Constraints on Growth in Europe: Actionable Priorities to Deepen the Single Market," IMF Working Paper 25/113.

[35] Capelle and others (2026), "Barriers to a European Banking Union," IMF Working Paper 26/123; Brandao-Marques and others (forthcoming), "Are European Firms Financially Constrained?" IMF Working Paper.

liquidity to a broad set of central banks against high quality euro-denominated collateral could increase external demand for euro-denominated securities, spur more issuance, and deepen the capital market, while strengthening the global financial safety net.

44. Completing the banking union remains essential to reducing financial fragmentation and improving firms' access to finance across the euro area. Despite centralized supervision, cross-border bank lending and integration remain limited, reflecting persistent home-host frictions arising from nationally anchored deposit insurance and resolution frameworks, and political resistance to cross-border consolidation. While recent reforms to the crisis-management and deposit-insurance (CMDI) framework aimed to reduce reliance on national, taxpayer resources to support bank resolutions, the Banking Union will remain incomplete without a stronger financial safety net to weaken the sovereign-bank nexus and support confidence in cross-border activity—through a European Deposit Insurance Scheme (EDIS), a fully operational common backstop to the Single Resolution Fund supported by the ESM, and stronger arrangements for access to central bank liquidity in resolution. Facilitating cross-border bank mergers would further support a more even provision of credit across countries.

45. Removing significant obstacles to labor mobility can enable talent to match more efficiently with vacancies. These include burdensome procedures for posting workers, uneven and slow recognition of professional qualifications, incomplete social security coordination, and limited pension portability. The European Court of Auditors found that around 60 percent of the barriers to the single market for services that were identified in 2002 persisted in 2023. While the Union of Skills initiative includes elements to improve the portability of skills across the EU, tangible policy actions remain limited in the other areas mentioned above. In particular, strengthening cross-border pension products, via the Pan-European Personal Pension Product (PEPP) framework, could help reduce uncertainty around retirement outcomes for mobile workers and ease an important deterrent to moving across borders.

46. Improving housing affordability could help increase labor mobility. Declining housing affordability—beyond widening inequality between renters and owners—contributes to limiting labor mobility amid binding supply constraints. Policies should focus on expanding housing supply, including by releasing land for residential construction, streamlining permitting procedures, and improving access to finance for developers. Labor shortages in the construction sector also need to be addressed. In many countries there is room to raise the low stock of social rental housing, either directly via the public sector or via financial incentives to private developers. While many of these measures need to be taken at the national level, EU-level action can complement national efforts, starting with deepening the single market for construction—one of the least traded services in the EU (Annex II). These measures would improve workers' ability to move to more productive regions, resulting in a more efficient allocation of labor.

47. Competition enforcement is an essential complement to achieving dynamism and effective cross border scale up. The Commission's ongoing review of merger guidelines rightly aims to provide clarity and predictability on merger assessments, including with considerations for the innovation potential of proposed mergers. It is essential to continue safeguarding market

contestability. Constraints to firm scale-up stem from remaining frictions within the single market, including regulatory fragmentation, rather than from competition enforcement.[36] Relaxing merger rules with the goal to create "European champions" could entrench firm-level market power, especially in still-segmented national markets, ultimately hurting innovation.

Strengthening Innovation

48. Enhancing AI readiness requires regulatory simplification and equipping workers with the skills and protections needed to adapt. The AI Omnibus—which seeks to defer compliance burdens to feasible deadlines and resolve overlaps with sectoral legislation—has been provisionally agreed and should be formally adopted. Given the rapid pace of AI development, consideration should be given to providing greater scope for experimentation, while keeping the fundamental risk-based architecture intact. AI adoption holds prospects of productivity gains and could help mitigate labor supply challenges from demographic changes. However, its rapid diffusion could also intensify labor market disruptions, implying a need to increase labor market preparedness, foster labor mobility (¶45), and strengthen worker protection of those affected negatively. The IMF's AI preparedness index suggests that only a small number of EU countries are at the frontier of readiness for AI diffusion. The Commission's Union of Skills initiative aims to strengthen vocational training and expand reskilling opportunities for workers affected by technological change. However, the initiative lacks clarity on implementation, scale, and binding commitments. Stronger efforts and adequate EU-level funding could help contain labor market adjustment costs and broaden the benefits of AI deployment.

49. Moving forward with the digital euro, alongside supportive policies for secure and innovative market infrastructures, can support cross-border financial integration. As cash use declines and private digital payment solutions, often relying on non-EU infrastructure, expand, a well-designed digital euro could increase efficiency of pan-EU retail payments. Proposed design features—including privacy safeguards and both online and offline functionality—seem appropriate, and the final design should continue to take due account of financial stability considerations, including potential implications for bank intermediation and liquidity conditions. Ongoing work on wholesale CBDC would help preserve interoperability and the role of central bank money as the main settlement asset—while transactions shift to distributed ledgers and tokenization grows.

Diversifying Trade Relations

50. The EU should continue to foster trade policy certainty, while minimizing distortions and external spillovers. EU trade policy should continue to focus on reducing uncertainty—trade policy affects firms not only through expected tariff costs, but also by reshaping policy predictability in ways that influence firms' investment incentives.[37] The approval and implementation of the US-EU

[36] Arnold and others (2025), "Lifting Binding Constraints on Growth in Europe: Actionable Priorities to Deepen the Single Market," IMF Working Paper 25/113.

[37] Beyer and others (2026), "Trade Policy Shocks and Corporate Valuations – Disentangling Trade and Uncertainty Channels," IMF Working Paper 26/70.

framework agreement should seek to minimize distortions that can arise from narrow preferential tariff liberalization. The Carbon Border Adjustment Mechanism (CBAM) entered into force in January 2026 —including a higher de minimis threshold, simplified procedures, and deferred financial settlement in the first year—while the EU Deforestation Regulation is set to apply from December 2026, reflecting a pragmatic advance in implementing EU climate-related trade policy. Further efforts can support firms at home and abroad, especially from developing countries, to adapt to these reforms.

51. **The EU should continue to diversify trade relations and maintain its leading role in supporting a more open, stable, and transparent trading system.** This includes supporting reforms at the WTO and the full restoration of the dispute settlement system, while deepening integration through regional, plurilateral, and multilateral agreements. In ongoing and future negotiations, the EU should seek broad-based and mutually advantageous agreements consistent with WTO rules. Staff analysis suggests that "deep" preferential trade agreements—including EU-Mercosur and EU-India—which cover a broad set of legally enforceable provisions, have the potential to expand EU bilateral trade. Larger regional agreements, such as with CPTPP, could generate more sizable trade gains and may support greater trade diversification, including by anchoring the EU more firmly in a wider, rules-based trade network.[38] Tightening of steel import quotas and raising out-of-quota tariffs (on July 1) are likely to weigh on downstream producers, and generate spillovers to trading partners. To address unfair practices or import surges, temporary trade defense measures can be applied, within the bounds of WTO rules. Where trade and investment measures are put in place for national security reasons, including tariffs and export controls, they should be applied narrowly to minimize their negative effects at home and abroad.

D. Supporting Reforms with Stronger EU-Level Fiscal Coordination

52. **The EU budget needs to be strengthened—both in scale and in its financing framework—to meet growing needs for European public goods.** With repeated shocks straining national fiscal space and exposing the cost of fragmented responses, EU-level coordination in common priority areas can reduce duplication, leverage scale, and better internalize cross-border spillovers. At just 1 percent of EU GNI, the Multiannual Financial Framework (MFF) is structurally undersized for the scale of common needs. The Commission's proposal for 2028-2034 envisages only a modest increase to 1.26 percent of GNI (1.15 percent, excluding NextGenerationEU debt service)—likely falling short of Europe's investment needs.[39] Expanding common EU borrowing, backed by enhanced revenue sources, would allow the EU to invest when most needed, while smoothing fiscal costs over time. Regarding own resources, while the proposed new package presents a broadly balanced mix, the turnover-based corporate levy (CORE) risks cascading distortions and may undermine single-market neutrality. Greater reliance on EU-aligned, economically efficient, and

[38] Caselli and others (forthcoming), "EU Trade Diversification through Regional Trade Agreements," IMF Working Paper.

[39] Busse and others (2025), "Making the EU's Multiannual Financial Framework Fit for Purpose," IMF Working Paper 25/114.

administratively robust bases, including the harmonized VAT or the ETS revenues, could help strengthen the system (e.g., increasing call rates on the VAT and ETS revenues by 0.1 percentage point or 20 percentage points, respectively, could generate more or comparable resources to projected yields from CORE). Over the medium term, adopting a harmonized EU corporate tax base—such as Business in Europe: Framework for Income Taxation (BEFIT)—and incorporating it into own resources could deliver efficiency gains and sustainable EU-level revenue (Annex III).

53. **The EU budgetary framework should have tools for timely, coordinated, and credible support in the face of large shocks, including through common borrowing.** The RRF experience provides useful guidance for the design of future EU-level instruments. Staff analysis suggests that linking reforms and investments with performance-based disbursement can be effective when grounded in strong national ownership, focused on macro critical measures, and calibrated to implementation capacity.[40] Parsimony in the number and complexity of milestones and targets, greater use of outcome-oriented indicators where feasible, complementary technical support, and built-in flexibility to adapt to changing conditions can help maximize impact while limiting administrative burdens. The RRF is found to have effectively supported employment and output in the near term through front-loaded investment particularly in construction and services, with longer-term gains from back-loaded investments and structural reforms expected to lift private investment and productivity.[41] However, with a few months left till completion and around 30 percent of funds yet to be disbursed, speeding up the process while maintaining adequate quality control is crucial for maximizing impact. The overall macroeconomic impact will ultimately depend on how effectively the RRF funds are utilized. The next MFF, with its proposed national and regional partnership, plans could carry forward RRF reforms and investments to ensure their benefits are fully realized. More recently, SAFE (Security Action for Europe)—a €150 billion loan facility aimed at strengthening defense capabilities and promoting joint procurement—illustrates how centrally coordinated, scalable instruments can be deployed to address system-wide challenges while reducing fragmentation.

Authorities' Views

54. **The Commission outlined a combination of measures to address the energy shock and accelerate the energy transition.** They emphasized that the near-term response to the energy shock includes a fiscal policy toolbox, a temporary state aid framework, and improved monitoring tools to track demand and supply. The authorities expected the shock to accelerate the energy transition, as reflected in rising EV and heat pump sales. They noted that structural measures to support decarbonization—in as far as State aid may play a role—remain anchored in the Clean Industrial Deal State aid Framework (CISAF) as well as the Climate, Energy and Environmental Aid Guidelines (CEEAG), complemented by competitively allocated EU-level tools—such as the

[40] Busse and others (2026), "The EU's Recovery and Resilience Facility: Experience and Lessons for the Next Multiannual Financial Framework," IMF Working Paper 26/114.

[41] Busse and others (2026) further suggests that while approval, implementation, and time-to-build constraints imply long lags before spending translates into demand, the announcement of a large, jointly financed EU-level program appears to have delivered a more immediate macro-financial impact by stabilizing sovereign debt markets and compressing risk premia.

Innovation Fund and Hydrogen Bank—financed by ETS revenues. Timely political agreement on the Grids Package—which would strengthen the EU planning framework, increase financing flexibility, and facilitate permitting—would be crucial, with its impact amplified if paired with increased funding for the Connecting Europe Facility in the next MFF.

55. The authorities emphasized that industrial policy needs to address multiple objectives (competitiveness, economic security and decarbonization) and designing effective instruments is crucial to managing the potential trade-offs. They recalled that EU's trade openness has increased since 2014 and the level of industrial support remains modest in the EU, whilst the opposite is observed for the EU's main competitors. They recalled that in some cases highly concentrated global supply chains (e.g., solar, batteries), together with the risk of coercion, leave very little room for diversification. They agreed that policy choices should account for implications for other priorities and avoid creating future dependencies, including technological dependencies, favoring a balanced approach that weighs both the scale of current and arising exposure, the costs of restricting particular sources and the "resilience gains." In this sense, the careful analysis and detection of key technologies on which to focus investment becomes crucial to ensure efficiency and effectiveness. The IAA proposes measures to strengthen strategic autonomy and advance decarbonisation and competitiveness by boosting EU manufacturing capacity in selected strategic sectors and net-zero technologies. Underpinned by robust evidence, it ensures efficiency by limiting short-term costs while preserving long-term benefits. The authorities stressed that proposed interventions remain targeted and proportionate, aligned with identified risks, and anchored in clearly defined objectives—i.e., build a certain level of domestic capabilities in critical sectors, whilst also diversifying. New EU-level schemes—such as tender-based funding for strategic technologies (e.g., "AI Gigafactories")—aim to scale up investment while preserving single market integrity.

56. The authorities agreed on the importance of deepening the EU single market, underscoring the ambition and overall direction of reforms across important initiatives.

- *28th regime.* The Commission's proposal aims to reduce legal fragmentation and facilitate cross-border scale-up.
- *Savings and Investments Union*. The authorities noted that the Market Integration and Supervision Package will help strengthen market integration and supervisory convergence in financial markets and build scale in trading, post-trading settlement and asset management. The authorities also emphasized complementary reforms to mobilize long-term risk capital, including advancing securitization, developing savings and investment accounts, and strengthening pension systems.
- *Digital euro.* The authorities continue to work on the digital euro to enhance the efficiency of pan-European payments and support financial integration and the EU's sovereignty. They noted progress in the legislative process and emphasized that it will complement private solutions and cash.

57. The authorities viewed an effective trade policy toolkit as crucial, while reiterating their support for a rules-based multilateral trading system and WTO reform. The authorities noted

that the EU has stepped up the use of trade defense instruments, including more flexible applications of anti-dumping and anti-subsidy measures, in response to foreign overcapacity and non-market practices. The authorities continue to monitor trade diversion and noted plans to strengthen protection for the steel sector by replacing temporary safeguards with more stringent tariff rate quotas—a change that would require renegotiation of their WTO commitments. The authorities reiterated that they see the WTO as a critical institution for maintaining a rules-based multilateral trading system and will continue to work toward reforms to deal cooperatively with industrial policies and spillovers from imbalances. They also underscored the role of expanding bilateral and plurilateral trade agreements in supporting diversification, strengthening economic security, and promoting predictability in a more volatile global trade environment.

58. The authorities concurred on the importance of effective competition enforcement. The ongoing review of merger guidelines seeks to modernize the assessment framework, through introducing a unified approach for horizontal and non-horizontal mergers and expanding the analytical toolkit. The authorities highlighted greater openness to dynamic efficiency and innovation considerations, while stressing that enforcement will continue to address market power effectively.

59. The authorities underscored that the AI Act's risk-based approach enables innovation while building trust. They acknowledged practical implementation challenges, which prompted the AI Omnibus—extending compliance deadlines for high-risk systems and reducing regulatory burdens. They also pointed to AI regulatory sandboxes as a mechanism for structured experimentation under supervisory oversight with the aim to provide regulatory learning, viewing these measures as evidence that the EU is addressing legitimate concerns while preserving the Act's fundamental architecture.

60. The Commission emphasized that RRF implementation is progressing and agreed on simplification as a key lesson for the next MFF. The European Council last year concurred on the objective to reach an agreement on the next MFF by end 2026. This shows the importance of ensuring that funds are available in a timely manner. The next framework is expected to provide for new and existing needs. To that effect, important transformations are under discussion for a budget more focused on EU priorities—notably competitiveness—simpler, more adaptable, and efficient. All member states are anticipated to submit payment requests in the fall, and closure guidance has been shared with member states that reiterates the 2026 deadline. The revised plans aim to address technical and implementation constraints rather than reduce ambition. Nevertheless, complexity remains a key challenge, underscoring the need for simplification in the next MFF. Moreover, implementation remains uneven, reflecting reform-related delays, outstanding assessments, and administrative bottlenecks, which in some cases imply risks for full disbursement. As a result, the authorities expect somewhat lower short-term macroeconomic impacts than previously projected, though effects remain sizable and are expected to continue to materialize in the long run, notably due to the implementation of structural reforms. Authorities also noted that resources are often channeled via national development or promotional banks, providing flexibility in the timing of spending versus disbursements.

61. The authorities highlighted that discussions on the next EU budget (2028-34) are progressing constructively. Strengthening the revenue base will be critical, with agreement on new own resources a key priority. The authorities emphasized the package approach to own resources to help balance distributional effects across member states. On the CORE proposal, while acknowledging the limitations of turnover-based levies, they noted that the design seeks to limit administrative and compliance burdens, apply broadly while exempting smaller firms, and is not expected to materially affect investment or location decisions due to its relatively limited size. Work is ongoing to assess additional revenue options proposed by the European Parliament. On the expenditure side, the authorities noted that discussions continue to focus on key design features, including performance-based approaches.

SAFEGUARDING FINANCIAL STABILITY

The growing footprint of NBFIs can amplify financial market stress in times of elevated volatility. At the same time, stablecoins can add to cross-sector and cross-border risks. Addressing these risks will require stronger cross-border supervisory cooperation, improved data and stress testing beyond banks, and more resilient financial safety nets. Ongoing efforts to simplify financial regulation and improve the effectiveness of supervision should support integration and efficiency while preserving prudential standards, in line with FSAP recommendations.

62. The euro area banking sector's aggregate capital and liquidity positions are adequate, but macroprudential buffers should be maintained to preserve loss-absorbing capacity. If there are renewed hostilities in the Middle East or other risks were to intensify and heighten market volatility, some of these buffers may have to be released to prevent further amplification via a credit crunch (see ¶28).

63. The authorities should continue to monitor vulnerabilities in the NBFI sector and its links to banks and to close relevant data gaps—a key recommendation from the 2025 FSAP. Stress originating in the NBFI sector can significantly amplify contagion, especially during periods of heightened market volatility.[42] Risks are heightened by banks' exposures to offshore hedge funds, increasingly active in sovereign funding markets, where supervisory visibility and data availability remain particularly limited. Therefore, the 2025 FSAP recommended enhancing cross-sector and cross-border risk monitoring and stress testing, supported by improved data collection and sharing, particularly for NBFIs. Accordingly, stress tests should cover off-balance-sheet exposures to nonbanks and incorporate additional risk-transmission channels (including repos and derivatives). The authorities also need to close data gaps regarding high leverage in parts of the NBFI sector, banks' off-balance-sheet exposures to NBFIs (e.g., committed credit lines, temporary borrowing arrangements, and derivatives) and state-contingent liquidity risks arising from repo transactions. The Commission's response to the targeted consultation on the adequacy of NBFI macroprudential policies provides an important opportunity to strengthen system-wide oversight.

[42] Valderrama and Varghese (2026), "Risk Propagation in the European Banking System: Amplification Effect from NBFIs and Market Risks," IMF Working Paper 26/33.

64. **The resources and prudential powers of the European authorities overseeing the NBFI sector should be strengthened and financial safety nets extended to the NBFI sector.** Empowering ESMA to top up national measures for significantly leveraged funds and to enforce cross-border reciprocation would prevent regulatory arbitrage. In the medium term, the authorities should prepare to provide emergency liquidity assistance (ELA) to the NBFI sector subject to robust oversight, while enhancing monitoring and transparency to mitigate moral hazard. Building on the ECB's January 2026 decision to reinstate access to monetary policy operations for banks in resolution (subject to supervisory confirmation of compliance with minimum own-funds requirements), financial safety nets should be strengthened with resolution and liquidity backstops, while ELA arrangements should be more fully harmonized to enable effective systemwide support during periods of stress (2025 FSAP). Moreover, the euro area would benefit from a strong common deposit insurance system and greater flexibility in the resolution of systemic banks, which could be achieved with a financial stability exemption to the rules on access to the Single Resolution Fund, as recommended in the 2018 and 2025 FSAPs.

65. **The authorities have advanced on implementing FSAP recommendations but further progress is needed.** The authorities have established an ESRB Temporary Task Force on System-Wide Stress Test Model Development to advance the development of system-wide stress testing. Such stress tests will help strengthen cross-sector monitoring of risks, interconnections, and possible contagion channels. The December 2025 SIU package proposes important steps toward more centralized supervision. The proposal includes reforms to ESMA's governance and funding that would expand its role in centralized supervision of cross-border capital market activities, strengthen supervisory convergence through more uniform application of rules, and provide more stable funding for enhanced data collection, risk monitoring, and stress-testing capacity. It is crucial to maintain the ambition of the wider reforms recommended in the 2025 FSAP. Specifically, focus should be on early activation of the countercyclical capital buffer, reforms to money market funds regulation, strengthening the TARGET Services oversight, and the expansion of the counterparty framework.

66. **EU financial regulation and supervision could be simplified, provided that prudential standards are not diluted.** Ongoing efforts to simplify EU financial regulation and streamline supervisory processes can support market integration by reducing supervisory heterogeneity and compliance costs for cross-border banks. It can also ensure risk-based supervision, provided that prudential standards and the operational independence of supervisors are preserved. The ECB's High-Level Taskforce on Simplification identifies areas where overlapping requirements and complexity in bank regulation can be reduced without weakening resilience and is a welcome step.[43] Streamlining reporting, enhancing proportionality, and improving coordination across supervisory authorities would help lower compliance costs, as long as it is carefully balanced against maintaining financial stability and it ensures that all segments of the banking system are subject to rigorous prudential standards. In all cases, efforts should avoid adopting the lowest-common-denominator

[43] The Taskforce informs the Commission's forthcoming report on simplification and the state of the EU banking system.

standards and ensure that efficiency or competitiveness objectives do not undermine financial stability.

67. A full, timely, and faithful implementation of Basel III by the EU remains essential to safeguard financial stability. This includes the Fundamental Review of the Trading Book, which should be concluded without further delays or deviations from international standards.[44] The authorities should continue to coordinate with other systemic jurisdictions to complete the global regulatory reform agenda, ensure a level-playing field, and avoid a race to bottom.

68. Enhanced cross-border supervisory coordination and cooperation is central to containing emerging sources of systemic risk. The ESRB recommendation on third-country multi-issuer stablecoin schemes highlights that cross-border issuance structures can amplify run and contagion risks when stablecoin reserves may need to be liquidated in the EU to meet redemption requests from outside the EU. Moreover, the EU's Markets in Crypto Assets Regulation (MiCAR) requirement that 30 percent of reserves of stablecoin issuers (60 percent for significant issuers) be held as bank deposits may increase banks' exposure to stablecoin-related liquidity risk during a redemptions surge. The authorities should prioritize enhanced cross-border supervisory cooperation to ensure that MiCAR is effective in mitigating systemic risks as stablecoin use increases. Absent strong supervisory cooperation agreements and consistent reporting and data access with third countries, MiCAR may need to be clarified to address concerns about the cross-border mobility of reserves during periods of stress. Moreover, strengthening AML/CFT oversight remains critical to mitigate cross-border financial integrity risks, including those arising from stablecoins and other digital financial activities (see Box 1).

Authorities' Views

69. The authorities emphasized the need to preserve macroprudential buffers, assessing current levels as broadly appropriate. While further tightening may be warranted in some member states, prevailing cyclical conditions were not seen as justifying additional tightening or release. They concurred that the forthcoming system-wide stress test will be a key tool to assess cross-sector risks and resilience, with an initial top-down exercise—focused on short-term liquidity—planned for end-2028. In this context, the authorities stressed that strengthening cross-institutional data sharing remains a priority to close key data gaps. They emphasized that regulatory simplification should reduce complexity and compliance burdens while preserving strong prudential standards. Noting growing pressure to ease capital requirements to support bank competitiveness, they stressed that the key constraint lies in limited scale and fragmentation within the single market. There is no evidence that current capital requirements are impairing euro area banks' ability to lend. The authorities also noted stablecoin risks as currently contained but potentially growing, particularly through cross-border issuance and bank linkages—warranting closer monitoring. They underscored that the enhancement of the Eurosystem Repo Facility for Central Banks (EUREP) supports the smooth transmission of monetary policy, with its global euro liquidity backstop nature contributing towards strengthening the global financial safety net. Finally, authorities highlighted the need for

[44] Euro Area Publication of financial sector assessment program documentation—detailed assessment of observance—Basel core principles for effective banking supervision.

deep cooperation with national jurisdictions, including on data sharing, to ensure that AMLA can complete its EU-wide risk assessment and commence direct supervision in 2028.

Box 1. Euro Area: Strengthening AML/CFT Oversight in the EU

Financial crime, including money laundering and terrorist financing (ML/TF), poses growing macroeconomic and financial stability challenges. While risks remain present in the banking sector, vulnerabilities are increasingly shifting toward NBFIs and other segments of the financial system where supervision may be less consistent. The misuse of stablecoins[1] and other virtual assets along with increased risk of digital fraud is creating additional channels for illicit transactions, while persistent risks—such as illicit financial flows from high-risk jurisdictions—could become more pressing amid geopolitical fragmentation. Fragmentation of payment systems and potential weaknesses in AML/CFT preventive measures may increase exposure to those risks, including regulatory, reputational, and operational risks linked to sanctions evasion in the current geopolitical context. Cross-border risks continue to evolve, and uneven AML/CFT supervision across jurisdictions leaves gaps that could undermine financial integrity and market confidence.[2]

Continued efforts at both the EU and national levels are needed to strengthen the AML/CFT frameworks and risk-based supervision of the financial sector, thereby reducing the macro-financial risks posed by ML/TF vulnerabilities. Authorities should enhance data sharing within the EU and with non-EU AML/CFT authorities to improve detection of cross-border illicit flows and emerging threats, including the misuse of stablecoins. The establishment of the European Authority for Anti-Money Laundering Authority and Countering the Financing of Terrorism (AMLA) is a welcome development. AMLA should ensure that a robust risk assessment guides the selection of approximately 40 institutions under its direct supervision, with particular attention to inherent ML/TF risks and cross-border activities, while supporting countries with less-developed supervisory frameworks in strengthening capacity ahead of the start of regional supervision in 2028. In particular, relevant national and regional authorities should ensure that suitable arrangements are in place and data and required information are provided to AMLA in a timely manner, and that adequate resources are in place to ensure their quality and accuracy. To address risks related to sanctions compliance, authorities and financial institutions should strengthen the effectiveness of preventive measures, including customer due diligence, transaction monitoring, and clear supervisory guidance. Efforts should remain risk-based and proportionate so that resources focus on the highest ML/TF risks while avoiding unnecessary burdens on lower-risk activities and preserving the efficiency of financial intermediation.

[1] FATF, March 2026, Targeted Report on Stablecoins and Unhosted Wallets – Peer-to-Peer Transactions.
[2] EBA, Opinion on ML/TF Risks Affecting the EU Financial Sector, 2023.

STAFF APPRAISAL

70. Following a period of growth at potential and inflation at target, the euro area outlook has worsened. Energy supply disruptions because of the war in the Middle East have raised inflation and weakened growth. In the baseline (which assumes a cumulative policy rate increase of 50 basis points over 2026 relative to the pre-war level), headline and core inflation are forecast to stay above 2 percent into 2028. Risks are skewed toward weaker growth and higher inflation. Systemic financial stability risks remain elevated following the energy price shock, reflecting stretched asset valuations and vulnerabilities in the NBFI sector.

71. Policymakers must manage the macroeconomic consequences of the current shock while advancing structural reforms to boost medium-term growth and resilience. The immediate priority is to keep inflation expectations anchored and cushion the impact of shock within the available policy space. These efforts should remain consistent with the important, long-standing structural policy agenda to increase resilience and strengthen growth.

72. Monetary policy should be calibrated to the evolving inflation outlook. If incoming data are consistent with the baseline projection, a slightly more restrictive policy stance than assumed in the baseline might be needed to keep medium-term inflation expectations well anchored, prevent the energy cost shock from leading to generalized price increases, and ensure a more timely return of inflation to target. Alternatively, if energy prices and inflation expectations rise further than would be consistent with the inflation path envisaged under the baseline forecast, faster and/or larger tightening might be appropriate. However, if the increase in inflation expectations is paired with substantial deterioration in financial conditions and lower demand, a more negative output gap would limit inflation pressures and reduce tightening needs. Forward-looking communication and continued use of scenario analysis, as well as clear explanations of the reaction function, will be essential to navigate uncertainty, contain financial volatility, and preserve price stability.

73. Fiscal policy should rely primarily on automatic stabilizers in response to the energy price shock, while continuing medium-term consolidation under the EU fiscal framework. If adverse impacts intensify, any discretionary support should be temporary, well targeted, preserve price signals, and—where fiscal space is constrained—be at least partially offset. At the same time, the pre-war consolidation effort should continue, anchored in credible medium-term plans that combine expenditure prioritization, efficiency gains, and structural reforms. Strong and consistent implementation of the EU fiscal framework will be critical to guide adjustment and ensure policy credibility.

74. A comprehensive EU level energy strategy, supported by predictable policies, is essential to advance the energy transition and strengthen resilience. While recent progress has reduced vulnerabilities, the continued exposure to imported fossil fuels underscores the need to accelerate investment and deepen market integration. Advancing the Grids Package and expanding cross-border interconnections would help lower costs and reduce price dispersion, but a broader, system-wide approach—coordinating planning, investment, and market design—is needed to fully realize gains. Maintaining a stable and credible ETS is critical to preserve investment incentives. Temporary support measures should remain limited and carefully designed to avoid weakening these incentives.

75. Addressing external supply vulnerabilities requires a targeted and disciplined policy approach. Measures to reduce concentrated exposure to external supply risks can provide insurance against disruptions, but they are not cost free and should be guided by a careful assessment of benefits relative to fiscal and efficiency costs. Policy support should be limited to clearly identified market failures, rely on the least distortionary instruments, and minimize spillovers. Broad-based efforts to expand manufacturing capacity—such as elements of the proposed IAA—risk misallocation while not being well targeted at the vulnerabilities where resilience gains outweigh the efficiency and

fiscal costs. Policy interventions should therefore remain focused, proportionate, and closely aligned with specific resilience objectives.

76. Deepening the single market remains the most effective way to strengthen growth and resilience, which would ensure sustainable external balance. Reducing legal fragmentation affecting firms' cross-border operations through a voluntary 28th regime via an EU regulation could facilitate firm scale-up, while further development of key elements of a predictable, rescue-oriented insolvency framework would be needed to fully realize the 28th regime's benefit. Advancing the savings and investments union will be critical to mobilize risk capital and improve the allocation of savings toward productive investment. At the same time, progress on the digital euro could enhance the efficiency of cross-border payments and deepen integration in financial services.

77. A larger EU budget with a stronger financing framework would more effectively support growth and resilience. The budget remains structurally undersized relative to the scale of common needs. Expanding common borrowing, underpinned by a stronger own-resources base, would allow the EU to scale investment in European public goods. For new own resources, greater reliance on EU aligned, economically efficient and administratively robust bases—such as increasing the EU uptake from ETS revenues and harmonized VAT—could provide a more economically sound revenue base, while the proposed turnover based corporate levy risks introducing distortions. Over time, developing more stable revenue sources, including through a harmonized corporate tax base, would further support a stronger and more sustainable EU fiscal capacity.

78. The EU should continue to diversify trade relations and support an open and stable trading system. It should seek broad-based and mutually advantageous agreements and maintain a leading role in supporting WTO reforms. To address unfair practices or import surges, temporary trade defense measures can be applied, within the bounds of WTO rules.

79. The euro area's external position in 2025 is assessed as broadly in line with the level implied by medium-term fundamentals and desirable policies. A sustained pickup in private investment and productivity from a deeper single market and national-level reforms, alongside increases in public saving in some member states, can help preserve external balance over the medium term. While the current account is projected to rise gradually as the energy shock fades and fiscal consolidation in high-debt countries raises public saving, Germany's fiscal expansion, stronger euro area demand, and higher private investment are expected to limit the increase. These factors bolster external stability with favorable global spillovers.

80. The authorities should strengthen system-wide financial stability safeguards by advancing the implementation of FSAP recommendations. Stress tests should be extended to cover banks' off-balance-sheet exposures to nonbanks and additional risk-transmission channels. Proposed reforms to ESMA's governance and funding can help support data collection, monitoring, and supervisory capacity. Preventing regulatory arbitrage, however, will also require empowering ESMA to top up national measures. Building on the ECB's recent decision to reinstate access to monetary policy operations for banks in resolution, completing the financial safety net will require stronger resolution and liquidity backstops (including with the ratification of the ESM Treaty to

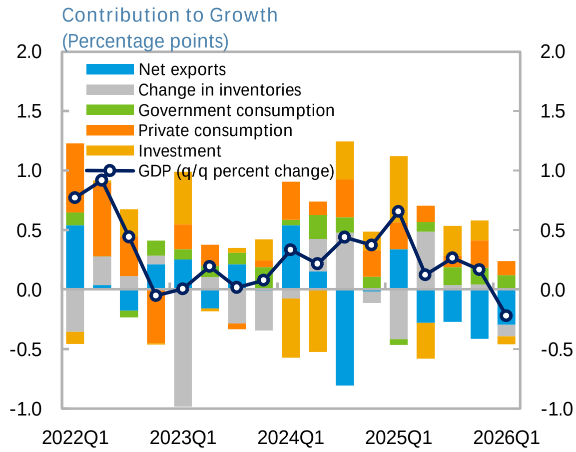
enable the ESM to act as a backstop for the Single Resolution Fund), harmonized emergency liquidity arrangements, and implementing a European Deposit Insurance Scheme. Reducing complexity in EU financial regulation, supervision and reporting should not be at the expense of prudential standards, and full and timely Basel III implementation remains essential.

81. Although not an imminent risk, stablecoins warrant attention. Strong cross jurisdictional supervisory cooperation is essential to mitigate the risk and—if this proves elusive—MiCAR's rules may need to be clarified to ensure orderly cross-border mobility and transfer of reserves during periods of stress.

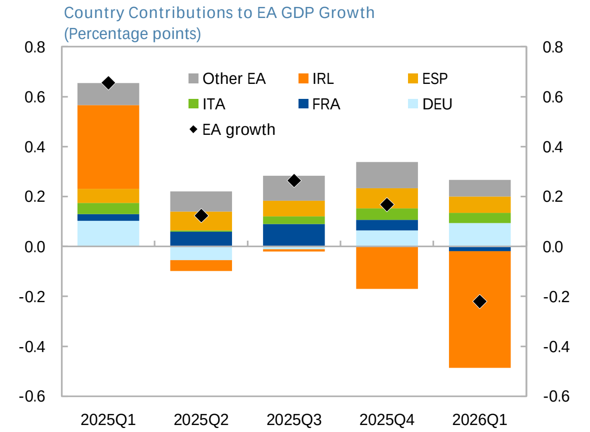
82. It is proposed that the next consultation on euro area policies in the context of the Article IV obligations of member countries follow the standard 12-month cycle.

Figure 1. Euro Area: Real Sector Developments

Despite several shocks, domestic demand—especially investment—held steady in 2025, but weakened into 2026.

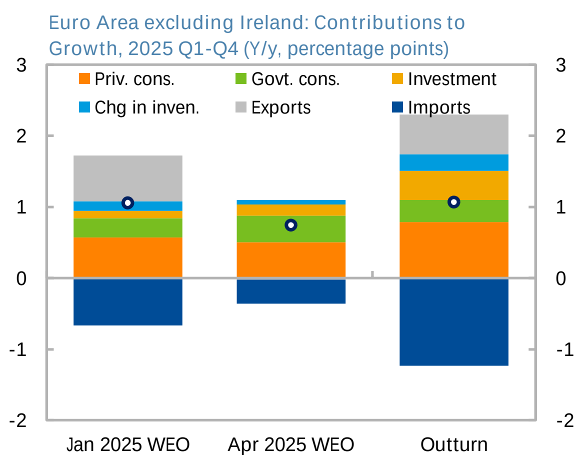


Ireland exerted a disproportionate influence on euro area growth, initially driven by a surge in pharmaceutical exports linked to trade front-loading in 2025Q1, followed by sharp reversal in 2026Q1.

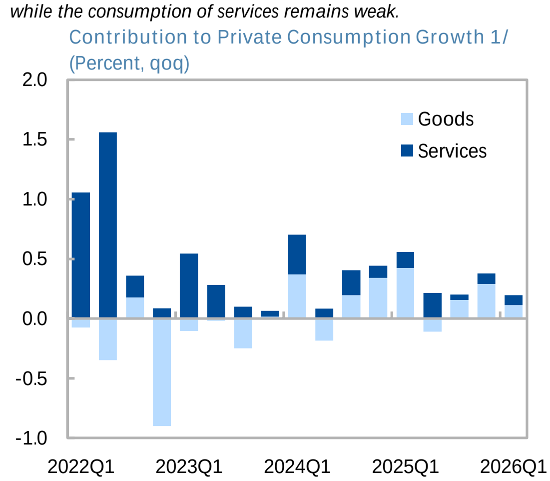


Sources: Eurostat; IMF WEO; and IMF staff calculations.

Net exports underperformed, reflecting strong import growth, while domestic demand proved resilient, offsetting external headwinds.

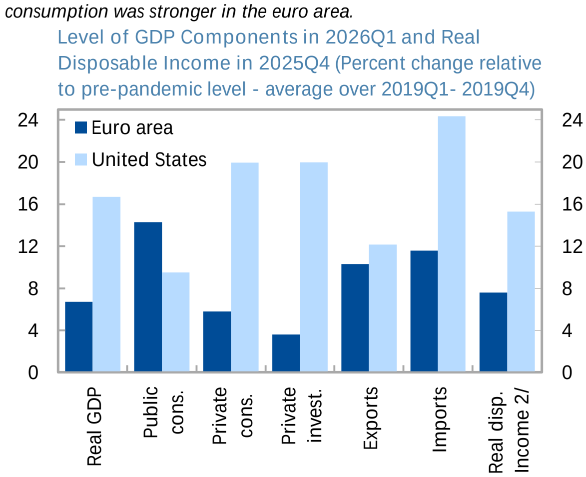


Consumption of goods was resilient in 2025, but weakened into 2026, while the consumption of services remains weak.



The energy shock struck with consumer confidence already persistently below the levels seen before the war in Ukraine.

Private domestic demand has lagged the US since 2019, while public consumption was stronger in the euro area.

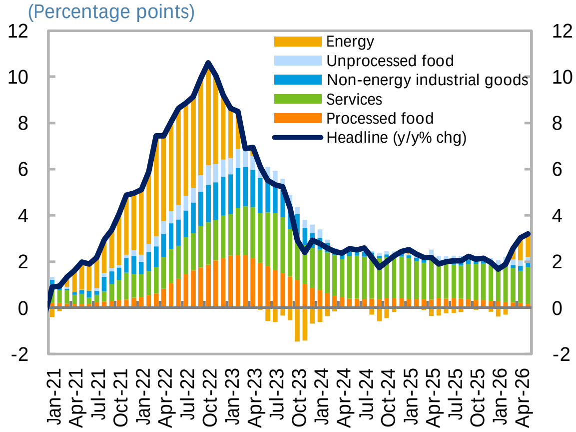


Sources: Bureau of Economic Analysis; European Commission; Eurostat; Haver Analytics; and IMF staff calculations.
1/ Euro area is proxied by the sum of the countries which publish disaggregated quarterly consumption data.
2/ Disposable income is deflated using the personal consumption deflator.

Figure 2. Euro Area: Inflation Developments

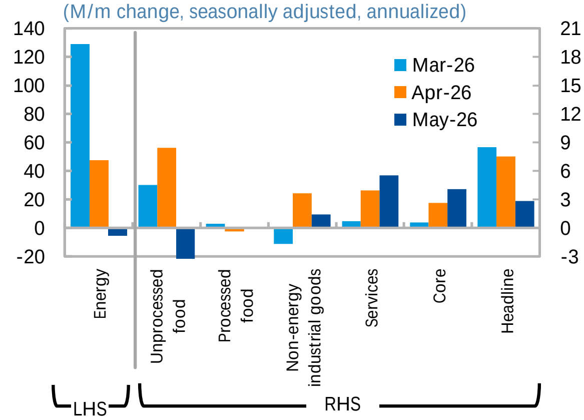
Headline inflation, fluctuating around 2 percent prior to the war in the Middle East, exceeded 3 percent in May, driven by rising energy prices.

Contributions to Headline Inflation, May 2026
(Percentage points)



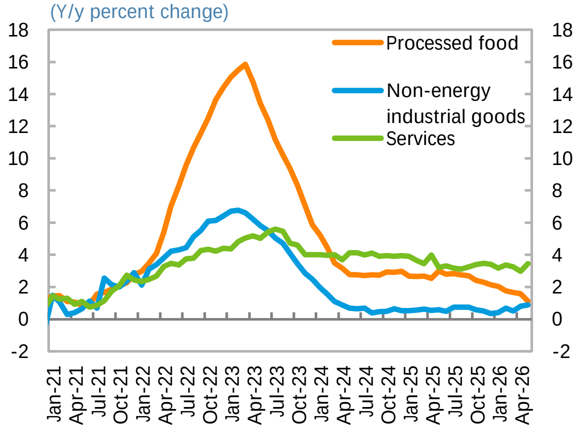
Recent sequential dynamics in core inflation point to early signs of broadening price pressures.

Sequential Inflation
(M/m change, seasonally adjusted, annualized)



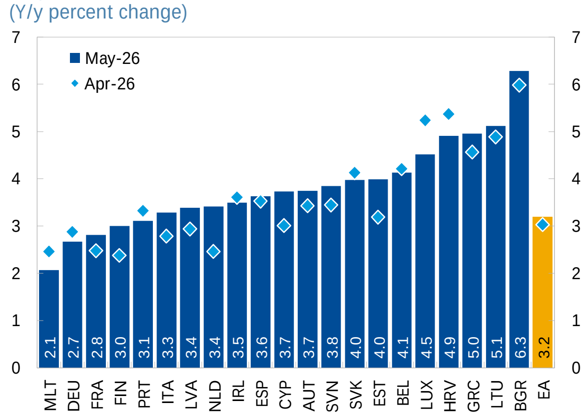
Among core components, services inflation is starting to pick up, with non-energy industrial goods firming, partly offset by subdued processed food inflation.

Inflation, Core Components
(Y/y percent change)



Inflation pressures are becoming more generalized across countries, with all member states above target and cross-country dispersion remaining wide.

Dispersion in Headline Inflation Across Member States 1/
(Y/y percent change)

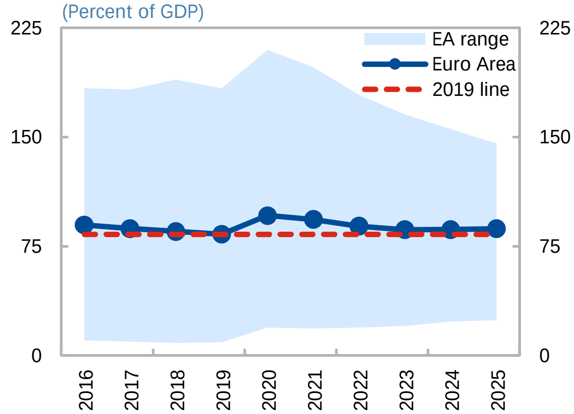


Sources: European Commission; Eurostat; Haver Analytics; IMF *World Economic Outlook*; and IMF staff calculations.
1/ Numbers inside the bars are the latest inflation rates.

Figure 3. Euro Area: Public Sector Accounts

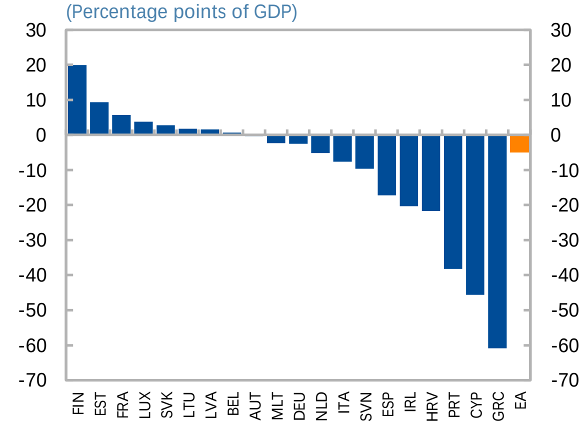
After declining from their pandemic peak, euro area public debt ratios have largely stabilized since 2023.

General Government Debt
(Percent of GDP)



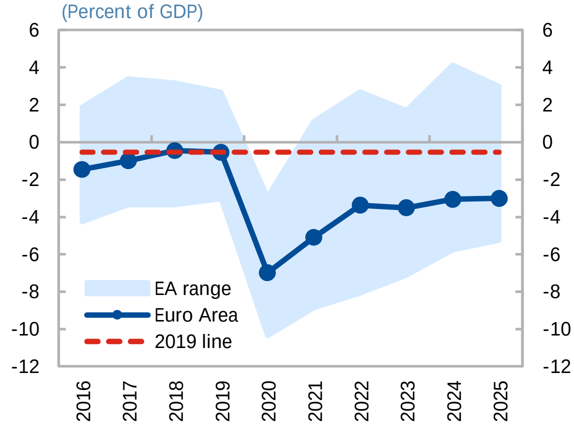
In most countries, public debt ratios declined mainly because of favorable debt dynamics.

Change in Public Debt between 2021 and 2026
(Percentage points of GDP)



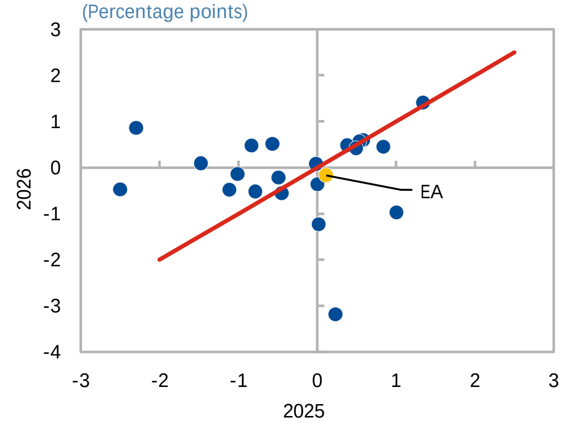
Deficit levels remain elevated.

Net Lending and Borrowing
(Percent of GDP)



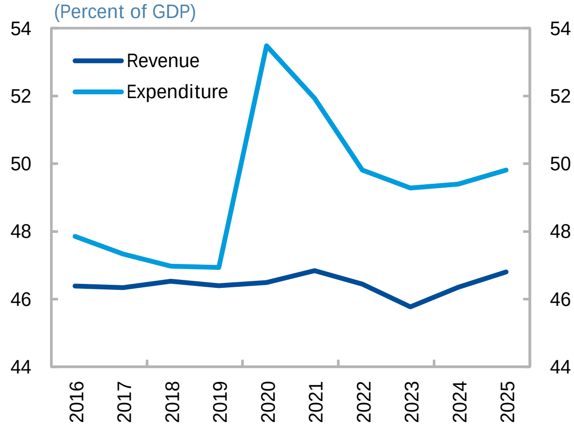
National fiscal policy is set to be mildly contractionary in 2026, with large cross-country differences; RRF support keeps the overall stance broadly neutral.

Change in Cyclically Adjusted Primary Balance
(Percentage points)



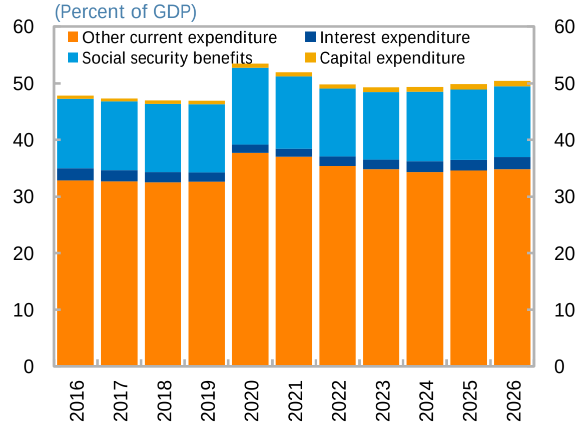
Government expenditures remain elevated, ...

Revenue and Expenditure
(Percent of GDP)



... driven mainly by non-social security primary current spending.

Government Expenditure Decomposition
(Percent of GDP)

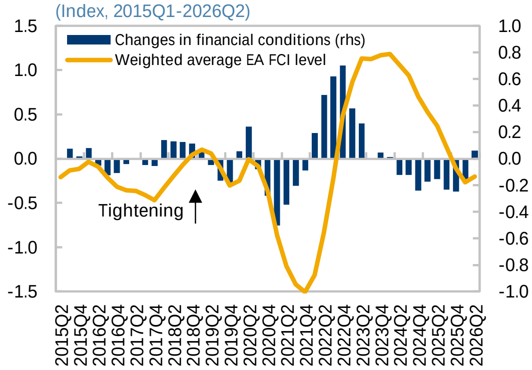


Sources: IMF *World Economic Outlook*; and IMF staff calculations.

Figure 4. Euro Area: Financial Stability Risks

Supported by monetary easing, financial conditions in the euro area had been broadly easing.

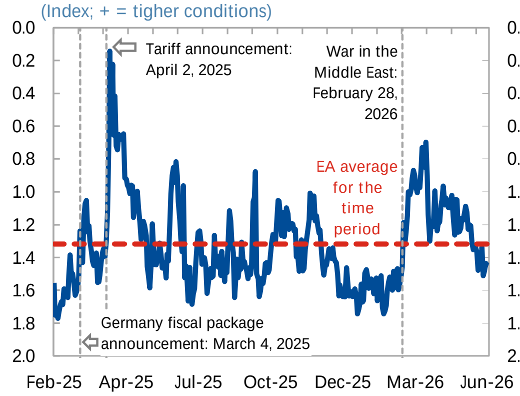
Financial Conditions 1/
(Index, 2015Q1-2026Q2)



Source: Borraccia et al., 2023, IMF Working Paper 23/209.

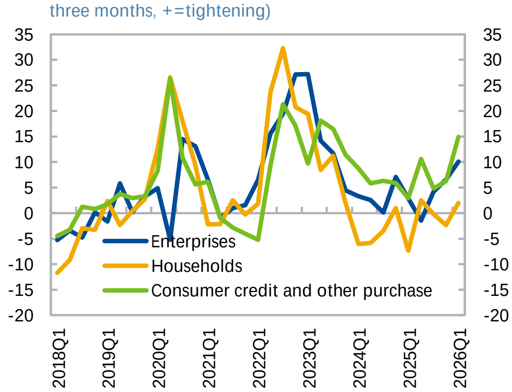
However, since the war in the Middle East, financial conditions have tightened though eased somewhat lately.

High Frequency Financial Conditions Index 2/
(Index; + = tigher conditions)



Credit standards for firms have tightened since 2025, reflecting banks' lower risk tolerance and higher perceived risks related to the economic outlook.

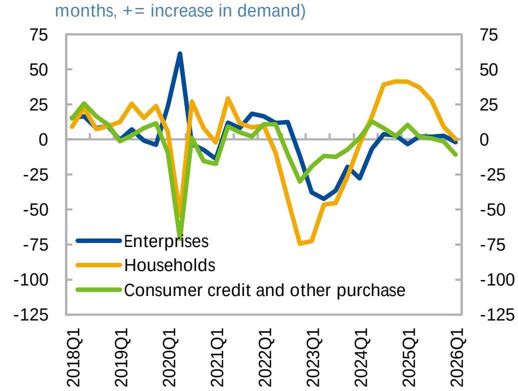
Changes in Credit Standards (Net percentages of banks reporting a tightening of credit standards over the past three months, +=tightening)



Source: ECB Bank Lending Survey.

Corporate credit demand edged up on inventory and working capital needs, while housing loan demand continued rising amid better housing market prospects and interest rates.

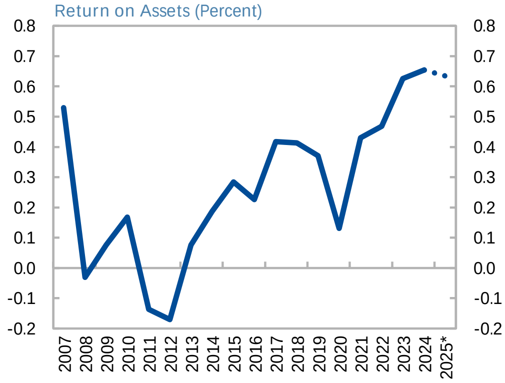
Changes in Credit Demand (Net percentages of banks reporting a tightening of credit demand over the past three months, += increase in demand)



Source: ECB Bank Lending Survey.

Bank profitability is expected to decline only gradually, as maturing loans are replaced at higher market rates.

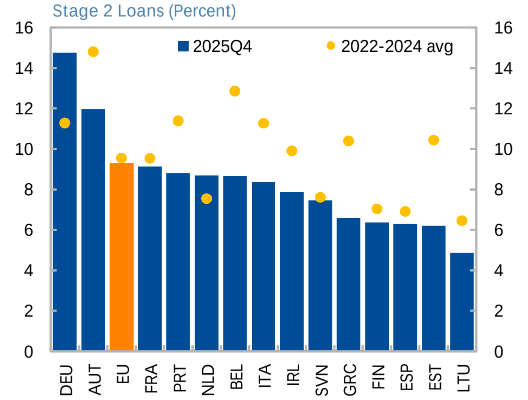
Return on Assets (Percent)



*2025 data is estimated.

Nonperforming loan ratios remain low, but "stage 2" loans have risen in some countries.

Stage 2 Loans (Percent)



Sources: Bloomberg Financial L.P.; Borraccia and others (2023), IMF Working Paper 23/209; ECB; and IMF staff calculations.

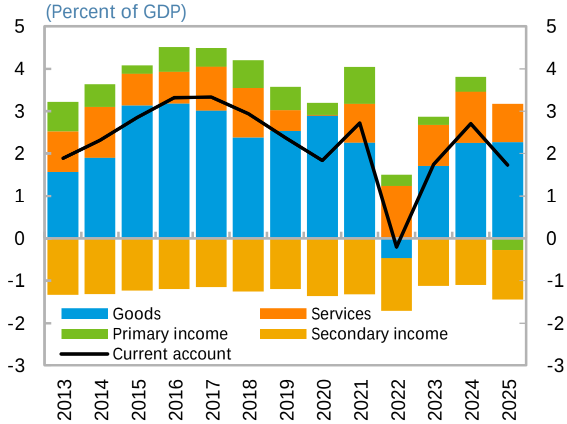
1/ Chart shows the liability-weighted average of the Euro area countries' Financial Condition Indexes. 2026Q1 and 2026Q2 are forecasts.

2/ All of the indicators included in the composite FCI index are normalized by subtracting the mean and dividing by the standard deviation for each series. The mean and standard deviation are calculated from observations during the pre-crisis period, which is defined as the period from 1999 to July 1, 2008. The FCI index is a Z-Score that indicates the number of standard deviations by which current financial conditions deviate from normal (pre-crisis) levels.

Figure 5. Euro Area: External Sector Developments

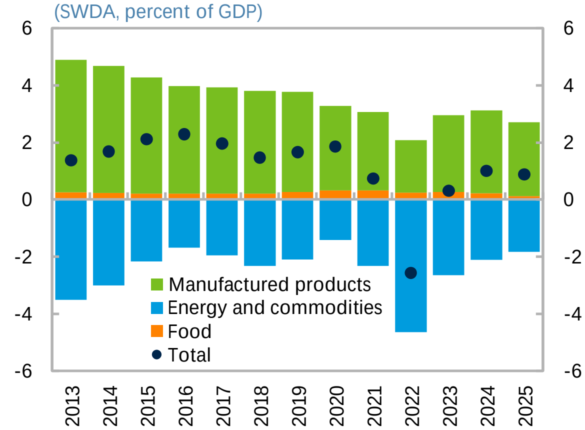
The current account surplus declined to 1.7 percent of GDP in 2025, reflecting lower income and services.

Current Account Balance
(Percent of GDP)



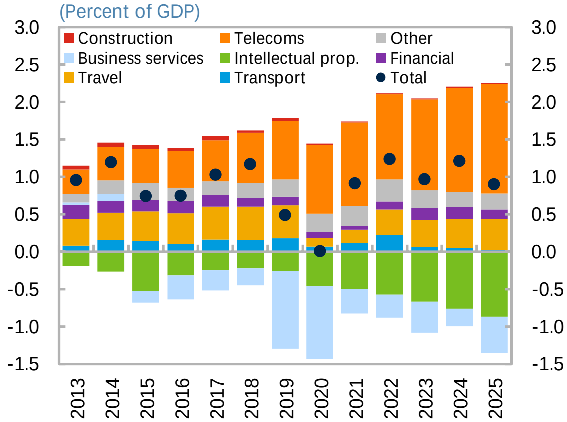
The energy and commodity deficit narrowed in 2025, and so did the surplus in manufactured products.

Net Trade Balance of Goods
(SWDA, percent of GDP)



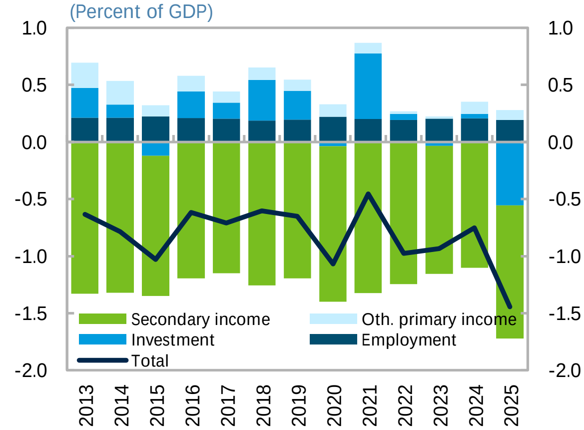
Larger deficits in intellectual property and other business services more than offset strength in ICT-related services.

Net Trade Balance of Services
(Percent of GDP)



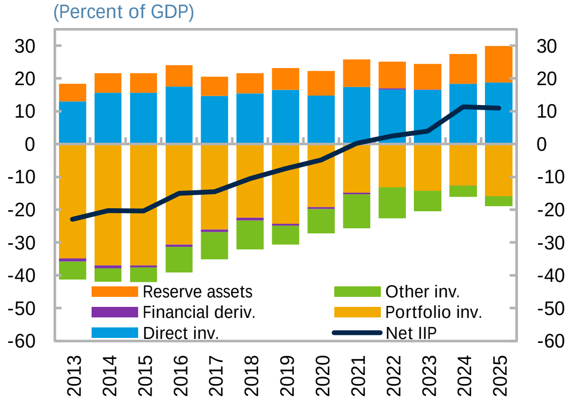
Primary income shifted from surplus to deficit, consistent with weaker net investment income.

Primary and Secondary Income Balance
(Percent of GDP)



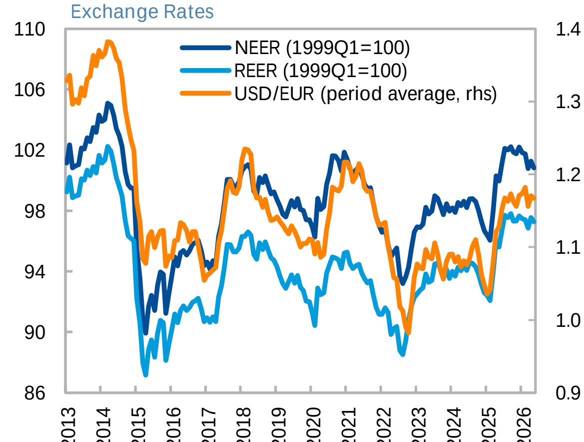
Unlike the steady improvement over 2022–24, NIIP movements in 2025 were largely valuation-driven.

Net International Investment Position
(Percent of GDP)



Exchange rates appreciated during the first half of 2025 and since remained broadly stable.

Exchange Rates



Sources: European Central Bank; Eurostat; Haver Analytics; and IMF staff calculations.

Table 1. Euro Area: Main Economic Indicators, 2022–2031[1/]
(Y/y percent change, unless otherwise specified)

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
					Proj.	*Proj.*	*Proj.*	*Proj.*	*Proj.*	*Proj.*
Demand and Supply										
Real GDP	3.6	0.5	1.0	1.4	0.9	1.2	1.4	1.2	1.1	1.1
Private consumption	5.3	0.5	1.3	1.4	0.9	1.1	1.3	1.2	1.1	1.0
Public consumption	1.3	1.5	2.3	1.4	1.9	1.3	1.0	1.0	1.1	1.1
Gross fixed investment	2.1	2.6	-2.4	3.0	1.3	1.5	1.9	1.7	1.5	1.3
Final domestic demand	3.7	1.2	0.7	1.8	1.2	1.2	1.4	1.2	1.2	1.1
Stockbuilding 2/	0.4	-1.1	0.0	0.2	-0.1	0.0	0.0	0.0	0.0	0.0
Domestic demand	4.0	0.1	0.7	2.0	1.1	1.2	1.4	1.2	1.1	1.1
Foreign balance 2/	-0.2	0.4	0.3	-0.5	-0.2	0.0	0.0	0.0	0.0	0.0
Exports 3/	7.4	-1.2	0.6	2.1	1.1	2.5	2.5	2.6	2.5	2.5
Imports 3/	8.4	-2.0	0.0	3.5	1.6	2.6	2.7	2.7	2.7	2.6
Resource Utilization										
Potential GDP	1.2	1.0	1.4	1.4	1.1	1.2	1.2	1.1	1.1	1.1
Output gap 4/	0.8	0.3	-0.1	-0.1	-0.3	-0.3	-0.1	0.0	0.0	0.0
Employment growth	2.4	1.5	1.0	0.8	0.2	0.2	0.2	0.2	0.1	0.0
Unemployment rate 5/	6.7	6.5	6.4	6.3	6.3	6.2	6.1	5.9	5.9	5.9
Prices										
GDP deflator	5.3	6.1	3.0	2.5	2.5	2.4	2.2	2.1	2.1	2.0
Consumer prices	8.4	5.4	2.4	2.1	2.9	2.3	2.2	2.0	2.0	2.0
Public Finance (percent of GDP)										
Overall fiscal balance	-3.4	-3.5	-3.0	-3.0	-3.5	-3.5	-3.3	-3.2	-3.1	-3.1
Primary balance	-1.9	-2.1	-1.5	-1.4	-1.6	-1.6	-1.3	-1.0	-0.9	-0.7
Structural balance 4/	-3.6	-3.7	-3.1	-3.0	-3.3	-3.4	-3.4	-3.3	-3.3	-3.2
Structural primary balance 4/	-2.1	-2.3	-1.5	-1.4	-1.5	-1.5	-1.3	-1.2	-1.0	-0.9
General government gross debt 6/	88.9	86.5	86.6	87.4	88.4	88.8	89.1	89.5	89.9	90.3
Debt of the EU institutions 7/	0.6	0.9	1.5							
External Sector (percent of GDP) 8/										
Current account balance	-0.2	1.7	2.7	1.7	1.1	1.3	1.5	1.6	1.7	1.8
Interest Rates (percent, end of period) 9/										
Euro short-term rate (€STR)	1.9	3.9	2.9	1.9	1.9	...	...	...	...	...
10-year government benchmark bond yield	3.0	2.9	2.8	3.2	3.5	...	...	...	...	...
Exchange Rates (end of period) 9/										
U.S. dollar per euro	1.1	1.1	1.0	1.2	1.2	...	...	...	...	...
Nominal effective rate (2005=100)	96.1	97.4	96.1	101.6	100.2	...	...	...	...	...
Real effective rate (2005=100, ULC based)	84.9	88.8	88.3	92.8	...	...	...	...	...	...

Sources: European Central Bank; Eurostat; and IMF staff estimates.
1/ Projections for 2026-2031 are based on July WEO 2026 projections of France, Germany, Ireland, Italy, Netherlands, and Spain (accounting for around 85% of EA GDP) and April 2026 WEO projections for others.
2/ Contribution to growth.
3/ Includes intra-euro area trade.
4/ In percent of potential GDP.
5/ In percent.
6/ General government gross debt is defined as the consolidated gross debt of the whole general government sector.
7/ The debt is percent of EU GDP and this includes debt financed by the EU budget, the European Stability Mechanism, the European Financial Stability Facility, the Single Resolution Board/Single Resolution Fund, the Modernisation Fund, the Joint Sickness Insurance Scheme, and the European Peace Facility, net of EU institutions' claims on member states—such as on-lent funds already reflected in national debt statistics.
8/ Projections are based on member countries' current account aggregations excluding intra-euro flows and corrected for aggregation discrepancy over the projection period.
9/ Latest available monthly data for 2026.

Table 2. Euro Area: External Sector Assessment

Overall Assessment: The external position in 2025 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The CA balance declined to 1.7 percent of GDP in 2025—down from 2.7 percent of GDP in 2024—driven mainly by weaker net investment income and services, while the goods balance held up. While the euro area's CA surplus is projected to gradually increase over the medium term it is projected to remain below 2 percent of GDP, though with imbalances in some countries. Potential Policy Responses: Policy responses should ensure sustainable external balance by supporting stronger domestic demand and a smooth handoff from public to private investment, while reducing country-level imbalances where needed. Deepening the EU Single Market and completing the Banking Union would offer a key win-win—raising productivity while enhancing resilience through scale and internal diversification. Improving coordination on public goods investment and enacting structural reforms can boost investment and private demand. These measures can help address the identified credit-related policy gap and offset the need for increased public savings in some countries. Delayed fiscal consolidation would support the external balance only temporarily, as it would eventually require a sharper and more disruptive fiscal correction. Where historical policy gaps at the national level are projected to persist, countries with excess CA surpluses should strengthen domestic demand. Germany's increase in defense and public investments and the recommended rotation from public to private spending in other countries will boost investment and help lift productivity, thereby help preserve external stability and generate positive spillovers. Policies should promote transparent, predictable and mutually beneficial trade policy frameworks. Industrial policies should remain targeted to where externalities or market failures prevent effective market solutions, be coordinated at the EU level, and minimize distortions.						
Foreign Asset and Liability Position and Trajectory	Background. The NIIP turned positive in 2022 and remained comfortably positive in 2025, reaching 11.0 percent of GDP (roughly unchanged from end-2024). Movements in 2025 were largely valuation-driven. Gross external debt declined modestly by end-Q4 2025, with the euro area's gross cross-border balance sheet remaining large even as the net position stays positive. As in past years, the aggregate NIIP continues to mask sizeable cross-country heterogeneity, with creditor countries holding large net external assets and debtor countries still carrying elevated net liabilities. SPEs account for a sizable share of direct investment positions. Assessment. Projections of continued CA surpluses over the medium term suggest that the NIIP-to-GDP ratio will rise further, at a moderate pace. However, year-to-year movements may remain volatile given the prominent role of valuation effects in 2025, even as the euro area retains a net creditor position. While the region's overall NIIP financing vulnerabilities appear low, large net external debtor countries bear an elevated risk of a sudden stop of gross inflows, especially in the presence of large gross cross-border balance sheets.					
2025 (% GDP)	NIIP: 11.0	Gross Assets: 256.8	Debt Assets: 93.8	Gross Liab.: 245.7	Debt Liab.: 87.2	
Current Account	Background. The CA surplus narrowed to 1.7 percent of GDP in 2025, from 2.7 percent of GDP in 2024, driven mainly by a deterioration in the income and services balances: primary income shifted from surplus to deficit, consistent with weaker net investment income, while the services surplus fell, as larger deficits in charges for the use of intellectual property more than offset continued strength in ICT-related services. The growing profit footprint of US affiliates weighed on direct investment income, while royalty payments by these firms to parent companies contributed to the widening services deficit. By contrast, the goods surplus edged up, supported in part by a continued decline in the energy deficit and strength in chemicals. The household saving rate eased from 14.8 in Q4 2024 to 14.4 percent in Q4 2025, while the household investment rate edged up from 8.5 percent to 8.8 percent over the same period. Business investment weakened further, with the corporate investment rate falling to 21.4 percent in Q4 2025—its lowest since 2015. As in previous years, surpluses remained concentrated in creditor economies, reflecting high saving and comparatively weak investment. Assessment. The EBA model estimates a CA norm of 0.7 percent of GDP, against a cyclically adjusted CA of 1.8 percent of GDP. This implies a gap of 1.0 percent of GDP. Adjustments of -0.1 percent of GDP were made to the underlying CA to account for portfolio retained earnings bias in the Netherlands. The unexplained residual of 0.5 percent partly reflects the activity of multinationals in Ireland. Staff assesses the CA gap to be 0.9 percent of GDP in 2025, with a range of 0.1 to 1.7 percent of GDP (considering a standard error of 0.8).					
2025 (% GDP)	CA: 1.7	Cycl. Adj. CA: 1.8	EBA Norm: 0.7	EBA Gap: 1.0	Staff Adj.: -0.1	Staff Gap: 0.9
Real Exchange Rate	Background. In 2025, the CPI-based REER appreciated by 2.2 percent, and the euro appreciated by 4.4 percent against the US dollar. The euro area CPI-based REER appreciated by 7.3 percent between 2015 and 2025 following a depreciation of nearly 20 percent in the post-global financial crisis period. As of March 2026, the CPI-based REER was 0.8 percent above its 2025 average. Assessment. Consistent with the IMF staff CA gap, the IMF staff assesses the REER gap to be -2.6 percent in 2025, with a range of -0.4 to -4.8 percent, based on the estimated CA-REER elasticity of 0.35. As with the CA gap, the aggregate REER gap masks a large degree of heterogeneity in REER gaps across euro area member states. In contrast, the EBA REER index and level models suggest an overvaluation of 5.1 percent and 2.7 percent, respectively.					
Capital and Financial Accounts: Flows and Policy Measures	Background. The euro area recorded a broadly balanced capital account in 2025 and sizable financial account flows. Net direct investment outflows persisted, as euro area residents increased net direct investment abroad while non-residents were slight net disinvestors in the euro area. Other investment expanded sharply on both the asset and liability sides, indicating stronger cross-border intermediation (e.g., deposits/loans). Portfolio investment flows were broadly offsetting in aggregate, with residents' net purchases of foreign securities roughly matched by non-residents' purchases of euro area securities, and financial derivatives remaining a small contributor. Assessment. Aggregate risks appear contained, supported by the euro area's net external creditor position and the euro's role as the second most important international currency. However, sizable gross financing needs and large cross-border balance sheets leave parts of the euro area vulnerable to tighter global financial conditions and episodes of market volatility, including via sovereign risk repricing and bank–non-bank linkages.					
FX Intervention and Reserves Level	Background. The euro has the status of a global reserve currency. Assessment. Reserves held by euro area economies are typically low relative to standard metrics, but the currency is free floating.					

Table 3. Euro Area: Risk Assessment Matrix[1] (Continued)

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
Global Risks			
Geopolitical Tensions and Intensification of Conflicts	High Rising geopolitical tensions, and a weakening of multilateralism, raise the risk of an escalation in military conflicts, accompanied by damage to key physical and financial infrastructure, disruptions in major transit routes and supply chains, higher migration pressures, additional financial frictions, and market volatility.	High Trade barriers and supply disruptions lead to shortages in crucial inputs, higher inflation and production bottlenecks that reduce economic activity and decrease confidence.	Well-calibrated macroeconomic stabilization policies. Diversify energy sources and secure supply chains to avoid shortages of critical raw materials. Diversify global partnerships and advance new free trade agreements. Use targeted instruments (e.g., safeguard procedures and anti-dumping, anti-subsidy, and anti-coercion measures) consistent with WTO principles.
Trade-related Risks	High *Protectionism and Trade Disruptions.* Tariff and nontariff measures disrupt global supply chains, weighing on activity while increasing inflation. Trade diversion triggers broader protectionism. Low *New Trade Agreements.* Tangible progress in trade talks reduces uncertainty and trade barriers. Wider cooperation on services, FDI, and taxation boosts investment and bolsters public finances.	High Weaker export growth, combined with higher uncertainty and weaker consumer and business confidence, will weigh on the corporate sector and result in lower investment and a slower recovery in private consumption, ultimately undermining productivity and lowering potential output. High Agreements with Mercosur and India mitigate negative impact from protectionism and trade disruptions elsewhere. A trade agreement with the US could reduce trade policy uncertainty. Closer EU–CPTPP could result in a quasi-multilateral network of rules-based trade.	Continue to advocate for a stable, rules-based global trading system and pursuing de-escalation and constructive engagement. Use targeted instruments (e.g., safeguard procedures and anti-dumping, anti-subsidy, and anti-coercion measures) consistent with WTO principles. Diversify global partnerships and advance new free trade agreements. Deepen single market and avoid industrial policy that creates distortions or provokes retaliation.
Disorderly AI Correction	High An abrupt revision in expectations of strong AI-led productivity gains causes a sharp market correction, investment decline, and wealth loss, which suppress demand	High A sharp repricing of AI-related assets could trigger a broad market correction, tightening financial conditions, reducing investment, and generating negative wealth effects. Spillovers could be amplified	Strengthen monitoring of AI-related financial risks and market concentration; ensure liquidity backstops and operational readiness to address market stress; and reinforce oversight of leveraged NBFIs and

Table 3. Euro Area: Risk Assessment Matrix[1] (Continued)			
Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
	and tighten financial conditions globally.	through highly concentrated equity exposures, leveraged non-bank financial intermediaries, and increased market volatility, with potential knock-on effects on credit supply and confidence.	market-based finance to limit contagion. Carry out clear communication and strong coordination among financial authorities to preserve confidence and prevent disorderly market dynamics.
Fiscal Vulnerabilities and Higher Interest Rates	High Higher public debt and deficit levels put further upward pressure on long-term interest rates, sharply tightening global financial conditions, amplifying currency volatility, and reducing consumption and investment that exacerbate adverse debt dynamics. Disruptions are amplified by increased role of price-sensitive investors and leveraged NBFIs in sovereign debt markets, limited market absorption capacity when NBFIs offload debt securities, higher roll-over needs on shorter sovereign debt maturities, and strong sovereign-financial nexus.	Medium Higher funding costs and a shift in risk sentiment will lead to bond repricing and financial tightening, reducing credit growth. Insolvencies increase, resulting in deterioration of bank balance sheets and profitability. Rates staying high for longer will also lead to housing market corrections. Sovereign spreads increase, straining fiscal sustainability in high-debt countries.	Enhance liquidity support to financial institutions and markets to avoid contagion and prevent liquidity shortages morph into insolvencies. Ensure strong coordination between the ECB and the national authorities on financial stability risks. Use counter-cyclical financial policy to support viable financial institutions.
Policy Uncertainty	High Elevated and wide-ranging policy uncertainty weighs on sentiment and holds back consumption and investment. Political interference in independent economic institutions erodes public confidence and trust and raises the risk of policy mistakes.	Medium While a further increase in policy uncertainty would weigh on the EU economy through the usual confidence, consumption, and investment channels, uncertainty is already elevated, suggesting that the marginal near-term impact on activity may be limited. However, persistent uncertainty—especially if accompanied by political interference in independent institutions—could have more material medium-term effects.	Accelerate single-market and SIU reforms to crowd in private investment and reduce reliance on confidence-sensitive demand channels. Enhance policy clarity and communication through transparent contingency planning and scenario-based guidance. Reinforce policy credibility, including through proper implementation of the EU fiscal framework.

Table 3. Euro Area: Risk Assessment Matrix[1] (Continued)

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
Structural risks			
Cyberthreats	High Cyberattacks on physical or digital infrastructure, technical failures, or misuse of AI technologies could trigger financial and economic instability.	Medium Depending on the country's level of digitalization and exposure to digital infrastructure, cyberattacks could disrupt the financial system as well as the real economy.	Advance crisis preparedness to cyberattacks. Further strengthen coordination at the European/international level. Strengthen the operational resilience of the financial system.
Climate Change	Medium Extreme climate events and rising temperatures could cause loss of life, damage to infrastructure, food insecurity, supply disruptions, and heighten economic and financial instability.	Medium Productivity declines or shortages lead to price increases. EU members may receive migrants from economies facing severe climate disruption.	Build fiscal space that can be activated to alleviate large discrete climate shocks. Establish a central fiscal capacity with the remit to finance mitigation of extreme climate events. Accelerate green transition to meet emission targets.
AI Acceleration	Medium Rapid AI adoption significantly improves productivity, boosts growth, and revives business dynamism. Realizing these gains requires complementary policies to manage energy constraints, scale critical inputs, and support labor market transitions.	Medium Faster-than-expected growth of productivity and medium-term growth. Near-term macroeconomic impact could be uneven across sectors and countries, with adjustment costs—including labor reallocation pressures, higher energy demand, and infrastructure bottlenecks—potentially limiting the speed at which aggregate gains materialize.	Accelerate investment in digital and energy infrastructure and ensure reliable access to critical inputs. Support labor market adjustment, through upskilling and reskilling, active and labor market policies. Deepen single market and SIU, to scale innovative firms, improve access to risk capital, and avoid fragmentation in AI adoption. Strengthen governance and competition frameworks, to promote innovation while addressing market concentration risks and ensuring trust in AI use through clear, proportionate regulation.
Euro Area Domestic Risks			
Realization of Financial Sector Vulnerabilities	Low A shift in market perception, along with high-for-longer interest rates, undermines	High Higher funding costs and a shift in risk sentiment will lead to bond repricing and financial	Enhance liquidity support to financial institutions and markets to avoid contagion and prevent liquidity

Table 3. Euro Area: Risk Assessment Matrix[1] (Continued)			
Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
	the ability to roll over and service debt, re-igniting financial fragmentation and adversely affecting the banking system.	tightening, reducing credit growth. Insolvencies increase, resulting in deterioration of bank balance sheets and profitability. Rates staying high for longer will also lead to housing market corrections. Sovereign spreads increase, straining fiscal sustainability in high-debt countries.	shortages morph into insolvencies. Ensure strong coordination between the ECB and the national authorities on financial stability risks. Use countercyclical financial policy to support viable financial institutions. Rely on bank resolution systems to address unsound banks.
Shifting sentiment on countries with high public debt	Low Policy slippages with weak growth outturns in some high-debt euro area countries, along with weak trust in the Governance Framework, could raise concerns over debt sustainability in high debt countries.	High Sharp increases in funding costs strain high-debt countries' ability to service their debt resulting in adverse real-financial feedback loops and financial fragmentation that weighs on economic activity and impairs monetary policy transmission.	Activate EU support lines for high-debt countries under stress. Make use of the TPI if higher spreads are not based on fundamentals. Enhance liquidity support to financial institutions and markets with strong coordination between the ECB and the national authorities.
Populism and Polarization	Low Real income loss, spillovers from conflicts, dissatisfaction with migration, and worsening inequality ignite populism, polarization, and resistance to reforms.	Medium Delayed and suboptimal policies weaken confidence and raise uncertainty, lowering growth and leading to market repricing. Delayed fiscal adjustment weakens fiscal sustainability and increases sovereign risks.	Increase growth and productivity, and ensure benefits are shared widely. Ensure that increased defense spending and fiscal consolidation do not undermine targeted social spending or exacerbate inequality. Provide temporary support to vulnerable households if needed.

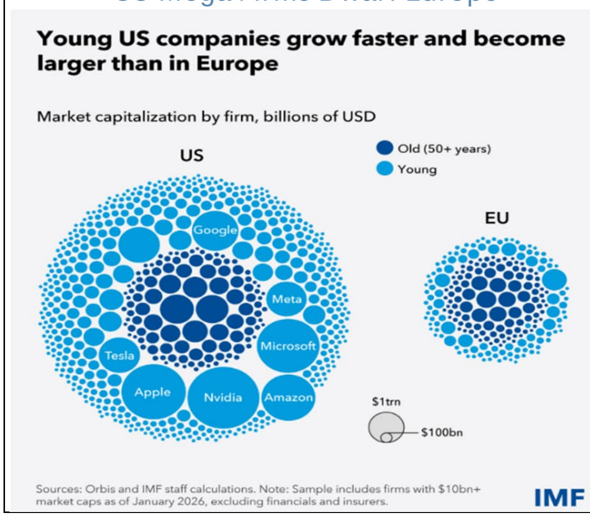
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline. Likelihood reflects staff's subjective assessment: "low" (below 10 percent), "medium" (10-30 percent), and "high" (30-50 percent). The RAM captures staff views on the source of risks and overall concern as of the time of discussions with the authorities. G-RAM operational guidance is available on the SPR Risk Unit website.

Annex I. A 28th Regime for European Firms: Toward a Single Rulebook for Cross-Border Scale-up[1]

Legal fragmentation remains a key obstacle to firm scale-up and capital allocation in the European Union. This annex discusses the case for introducing a "28th regime"—an optional, EU-wide legal framework for firms—as a targeted measure to reduce legal fragmentation in the single market. By providing a single rulebook for company formation, operation, and insolvency, the regime would facilitate cross-border scale-up, improve access to finance, and support firm dynamism. Model-based estimates suggest that a well-designed regime, particularly one that includes a robust insolvency framework, could deliver meaningful gains in productivity and output over time, with an increase of EU GDP by 3.3 (4.4) percent over 10 (20) years. This corresponds to almost 15 percent of the current EU-US hourly labor-productivity gap, underscoring that even partial progress on a targeted integration reform can meaningfully narrow Europe's productivity shortfall. The European Commission's recent proposal represents an important step in this direction, though further strengthening—especially of the insolvency component—would be needed to unlock the full economic benefits.

1. Despite the single market, enterprise activity in the European Union remains fragmented across 27 national company and insolvency regimes. This fragmentation imposes significant legal uncertainty and fixed costs on firms that operate across borders, requiring them to navigate multiple incorporation procedures, governance rules, reporting requirements, and restructuring frameworks.

US Mega Firms Dwarf Europe



2. These frictions weigh particularly on startups and scaleups, which typically lack the legal and financial capacity to manage cross-border complexity. As a result, firms often delay or forgo expansion beyond their home market, limiting their access to a larger customer base and to broader pools of financing. Fragmentation also constrains the efficient matching of capital with innovative firms and weakens incentives for investment, innovation, and risk-taking. Overall, it contributes to weaker firm dynamism, fewer firms able to scale at the EU level, and slower productivity growth compared to more integrated jurisdictions.

3. The proposed "28th regime" aims to address these challenges by introducing an optional, EU-wide legal framework that firms could choose instead of national systems. The regime would operate alongside existing national regimes and would not require their replacement. Under the 28th regime, firms would benefit from a single, harmonized rulebook covering key aspects of the firm life cycle—formation, operation, cross-border mobility, and insolvency. A company opting

[1] Based on Dizioli and others (forthcoming), "Toward a 28th European Enterprise Regime: A Single Rule Book to Enable Cross-Border Scale-Up in Europe," IMF Departmental Paper.

into the regime would operate under a single EU-wide legal identity, ensuring seamless recognition across member states and reducing the need to comply with multiple national systems. By lowering legal and administrative barriers, the regime would facilitate cross-border scale-up, improve access to finance, and strengthen the functioning of the single market.

Core Design Features

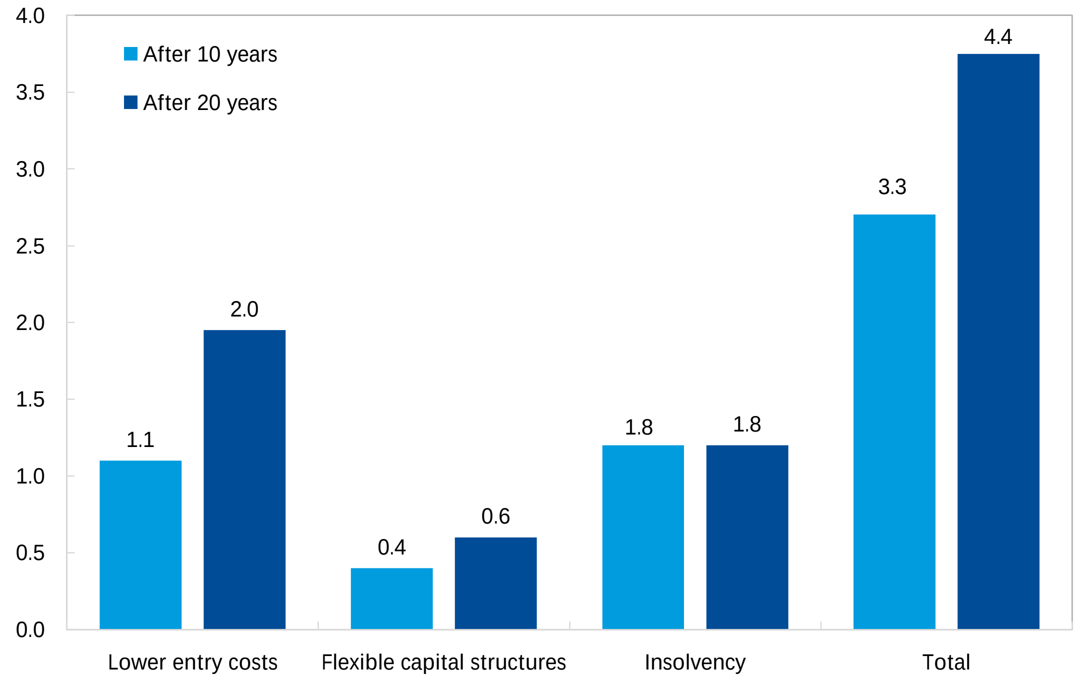
4. **The effectiveness of the 28th regime hinges on a limited set of core design elements that address the main sources of fragmentation along the firm life cycle.** Together, these elements would reduce compliance costs, improve financing conditions, and enable firms to expand across borders under a single legal framework.

- **Digital-first company law framework.** The regime would enable fast, low-cost, and fully digital incorporation through a single EU-wide interface, based on standardized templates. It would reduce administrative burdens through streamlined reporting and "once-only" submission of information. These features would lower entry costs and support firm creation and early-stage growth.
- **Flexible capital structures and financing tools.** The framework would provide legal certainty for modern financing instruments and allow firms to tailor their capital structures to the needs of venture and growth financing. This includes the ability to issue multiple share classes and to use equity-like instruments commonly employed in startup financing. Greater flexibility would facilitate access to risk capital and support cross-border investment.
- **A unified, rescue-oriented insolvency framework.** A central pillar of the regime is the establishment of a predictable and efficient insolvency system that emphasizes restructuring over liquidation. By harmonizing key aspects of creditor treatment and insolvency procedures, the regime would reduce legal uncertainty, lower credit risk premia, and improve recovery outcomes. This would support investment, enhance financial integration, and increase the resilience of firms.

5. **Model-based simulations suggest that a comprehensive 28th regime could yield significant macroeconomic benefits.** By reducing entry barriers, improving access to finance, and enhancing insolvency outcomes, the reform would support higher firm dynamism, investment, and productivity. The analysis is based on illustrative general equilibrium simulations that map these channels into entry costs, access to risk capital, and financing conditions.[2] Illustrative estimates indicate that the regime could raise EU GDP by about 3.3 percent over ten years, with larger gains over the longer term—of the magnitude of 4.4 percent GDP increase over 20 years—as dynamic effects materialize. The magnitude of these gains would depend on policy implementation, the extent of firm take-up, and complementarity progress in related areas. These gains would reflect stronger firm creation, improved capital allocation, and more efficient restructuring processes. The insolvency component is particularly critical for unlocking these benefits, as improved predictability of restructuring outcomes plays a key role in reducing financing costs and supporting investment.

[2] See Dizioli and others (forthcoming) for details.

Estimated GDP Impact of 28th Regime Pillars after 10 and 20 years (percent)



Sources: Dizioli and others (forthcoming); and IMF staff calculations.

6. The European Commission's recent proposal for an optional EU-wide company form ("EU Inc.") represents a substantial step toward the objectives of the 28th regime. It introduces a harmonized company law framework with digital-by-default incorporation, flexible financing structures, and simplified administrative processes. While the proposal is well aligned with the core elements of the 28th regime in the areas of company law and digitalization, its insolvency component is more limited in scope. In particular, it focuses primarily on simplified liquidation procedures for smaller firms. A more comprehensive, rescue-oriented insolvency framework would significantly strengthen the impact of the proposal by improving predictability for investors and creditors and by facilitating value-preserving restructuring. Based on illustrative staff estimates, excluding the insolvency channel would reduce the ten-year GDP impact to 1.5 percent, underscoring the central role of a robust, rescue-oriented insolvency framework in unlocking the reform's full economic potential.

Implementation Considerations

7. Given the political and legal complexity of harmonizing enterprise law, a phased implementation strategy is envisaged.

- Phase 1 would focus on company law and insolvency—areas where fragmentation is most binding for firm scale-up.
- Phase 2 could extend the framework to selected aspects of tax and labor law as consensus emerges.

- Phase 3 could deepen integration further depending on uptake and demonstrated benefits.

8. Political economy constraints partly explain both the gradual pace of progress and the cautious scope of staff's proposal. Overcoming these hurdles will require building broad buy-in by emphasizing the regime's voluntary nature and its focus on new and growing firms. By supporting investment, productivity, and resilience, the regime can generate benefits that are widely shared across the single market, helping to strengthen support for further integration over time.

9. Anchoring the 28th regime in a regulation—rather than a directive—is critical to ensure uniform application across member states and to minimize the risk of national gold-plating. A directly applicable legal instrument would provide firms with greater legal certainty and reduce fragmentation arising from divergent transposition into national law.

10. Safeguards would be needed to protect creditors, workers, and minority investors, and to prevent opportunistic use of the regime. Successful implementation would also require adequate institutional capacity, including specialized judicial expertise, interoperable business registers, and consistent application across member states. That said, even a regulation cannot fully eliminate fragmentation risks arising from differences in interpretation and enforcement by national courts. In practice, adjudication of 28th regime cases is likely to rely on specialized national courts, complemented by contractual arbitration mechanisms and oversight by the European Court of Justice to ensure convergence on core principles. This approach would help balance legal uniformity with operational feasibility, given budget constraints, political economy considerations, and the continued reliance on national procedural frameworks.

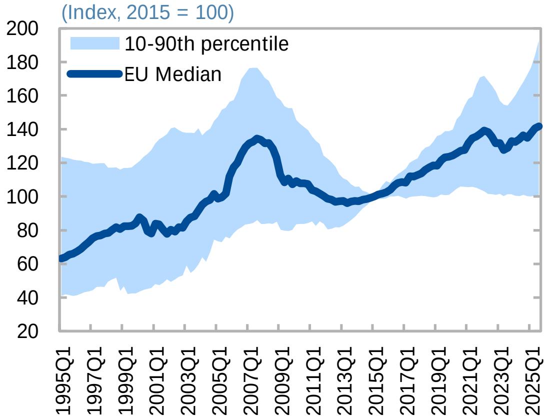
11. The 28th regime offers a pragmatic and targeted approach to reducing legal fragmentation in Europe without requiring full harmonization of national systems. By providing a single rulebook for firms operating across borders, it has the potential to support the emergence of larger, more productive firms and to strengthen Europe's innovation ecosystem. Given the magnitude of potential gains, advancing the initiative—while preserving its core design features and strengthening its insolvency component—would represent an important step toward deepening the single market and enhancing Europe's long-term growth prospects.

Annex II. Drivers and Implications of Declining Housing Affordability

Housing affordability is both a social concern and a macroeconomic challenge, with important implications for inequality and efficient labor allocation. Supply-side factors have become increasingly prominent drivers of house prices — a marked shift from the credit-driven before the Global Financial Crisis (GFC) boom. The burden has fallen disproportionately on lower-income urban renters, who face both rising rents and dwindling prospects of transitioning to ownership. Beyond widening the income and wealth gap between owners and renters, high housing costs impede labor mobility, with direct consequences for economic growth. Restoring housing affordability requires prioritizing supply-side measures at the national level, complemented by EU-level action to deepen the single market.

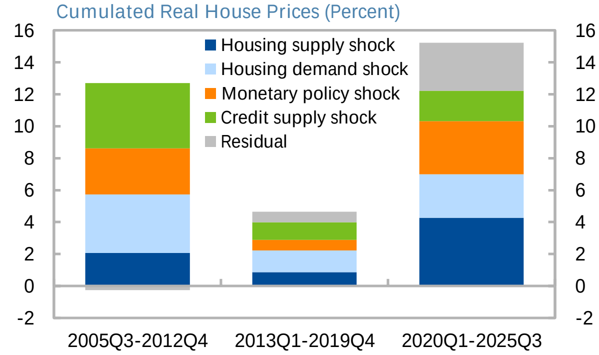
1. Affordable housing ranks among the most pressing concerns for EU citizens. Around 40 percent of EU households describe it as an immediate and urgent problem, and young people identify affordable housing and living costs as the area where they most want EU action (Eurobarometer, 2025). Housing affordability pressures are widespread across the EU, but severity varies markedly, with pressures consistently much stronger in capitals and fast-growing metropolitan areas. Against this backdrop, this annex asks three questions: What has driven house price developments over the past 25 years, how affordability has evolved across different household groups, and what are the distributional and macroeconomic implications of these developments. It concludes with a discussion of policy priorities.

European Union: Real House Prices
(Index, 2015 = 100)



Sources: BIS; Eurostat; and IMF staff calculations.

Period Averages: Contribution of Each Structural Shock to Cumulated Real House Prices (Percent)



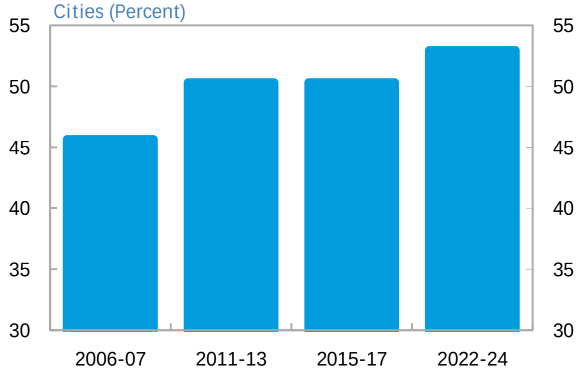
Sources: Authors' calculations.
Note: The chart shows the structural shock contribution to cumulated real house price (percent, relative to 2015 base), averaged over each period. The reported value is the simple quarterly mean of the per-quarter shock contribution.

2. Europe has experienced two distinct housing booms over the past 25 years— one ahead of the GFC and another since the pandemic—with markedly different drivers. Rapid house price growth ahead of the GFC was largely credit-driven, reflecting easy financing conditions and rapid mortgage expansion, and was accompanied by buoyant construction activity. The post-pandemic episode is different: credit conditions tightened after 2022, yet prices have continued to rise. A formal decomposition of cumulative house price growth since 2015, using a Structural Bayesian VAR with sign and narrative restrictions, points to easy credit and strong demand as the key

drivers of the pre-GFC boom, while limited housing supply becoming a more prominent driver in recent years. Labor shortages and financial constraints in construction appear as the binding supply-side bottlenecks, particularly in economies where construction sectors contracted after the GFC and have not yet recovered.

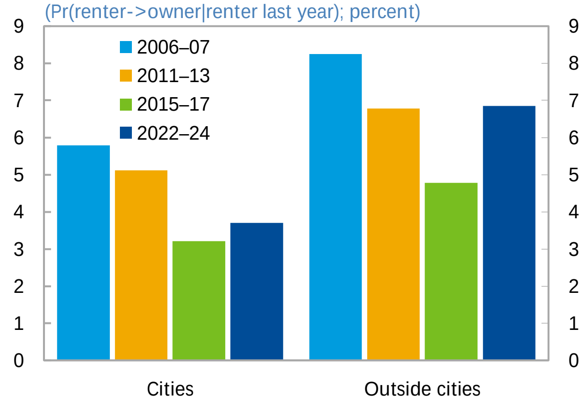
3. Rising housing costs have disproportionately affected renters, particularly lower-income urban households. For owners, low mortgage rates kept housing cost growth below disposable income growth through much of the past two decades. Renters faced the opposite dynamic, with market rents outpacing income growth. Among renters, the burden varies widely: those in the highest income quintile spend below 20 percent of disposable income on rent on average, while those in the lowest quintile spend around 40 percent—a level usually considered overburdened. Low-income urban renters are the most stretched, with their average rent-to-income ratio rising from around 45 percent before the GFC to 53 percent in 2022-24.

Median Rent to Income in the Bottom Quintile in Cities (Percent)



Sources: EU-SILC; and IMF staff calculations.
The median is a weighted average of 15 countries.

Probability of Transitioning from Renter to Owner (Pr(renter->owner|renter last year); percent)

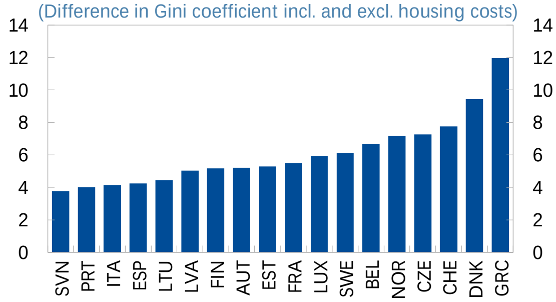


Sources: EU-SILC; and IMF staff calculations.

4. Becoming a homeowner has also become more difficult. While homeownership remains the dominant form of housing tenure in Europe, rates have been gradually declining—particularly among younger households. A hazard model on longitudinal EU-SILC microdata shows that the probability of transitioning from renting to owning has fallen over the past decades, especially in urban areas where it has declined by around one-third.

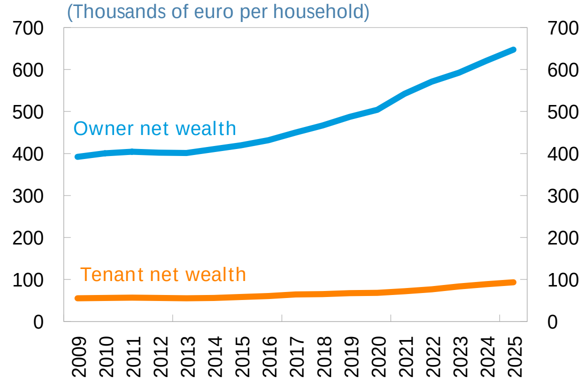
5. These trends have widened both income and wealth inequality. Disposable income inequality net of housing costs is significantly higher than disposable income inequality. In other words, housing costs contribute to accentuating income inequality in Europe. The effect on wealth is equally striking: since housing is the main asset for most European households, sharp house price increases have widened the gap in net wealth between owners and renters considerably.

Additional Inequality Caused by Housing Costs, 2024 1/
(Difference in Gini coefficient incl. and excl. housing costs)



Sources: EU-SILC; and IMF staff calculations.
1/ Inequality is measured as the difference between the Gini coefficient with and without housing cost calculated with equivalized disposable income, following Dustmann et al. (2018). A positive number indicates greater inequality if housing cost is taken into account. Equivalized disposable income controls for the differences in a household's size and composition.

Net Wealth by Tenure
(Thousands of euro per household)



Sources: ECB Distributional Wealth Accounts; and IMF staff calculations.

6. High housing costs also impede labor mobility, with direct consequences for economic efficiency and growth. Evidence drawing on an extension of the Blanchard-Katz framework—which tracks how regions adjust to region-specific labor demand shocks through unemployment, participation, and migration—applied to over 400 German districts and 65 European NUTS-1 regions, confirms that affordability matters. Following a positive regional labor demand shock, inward migration is significantly stronger when housing is affordable; when it is not, firms struggle to attract workers. Higher ownership, on the other hand, reduces outward migration after negative shocks.

7. Addressing Europe's housing affordability challenge requires action on multiple fronts—at both the national and EU level.

- *Supply-side measures should be the policy priority.* Key areas include releasing land for residential construction, streamlining permitting procedures, and improving access to finance for developers. Labor shortages in the construction sector also need to be addressed, including through active labor market policies to strengthen sectoral skills and greater contractual flexibility. In many countries there is room to raise the low stock of social rental housing, either directly via the public sector or via financial incentives to private developers.

- *Demand-boosting interventions should be avoided.* Absent supply responses, they risk widening the demand-supply gap, fueling house price growth, and worsening affordability.

- *EU-level action can complement national efforts, starting with deepening the Single Market for construction*–one of the least traded services in the EU. Priorities include harmonizing standards and product certification, reducing barriers to the intra-EU operation of construction firms, and mutual recognition of qualifications to ease cross-border labor mobility.

- *In line with the European Affordable Housing Plan, strengthening the EU's statistical infrastructure is also a priority.* Reliable, comparable data on rents and city-level prices remain a significant gap and a precondition for evidence-based policy targeting.

Annex III. New Own Resources for the EU Budget

The sustainability of the EU budget increasingly hinges on strengthening own resources grounded in sound tax design and aligned with EU-level policy objectives. In practice, this requires prioritizing revenue bases already governed at EU level, complemented by targeted, administratively feasible instruments. Turnover-based levies, such as the proposed Corporate Resource for Europe (CORE), fall short of sound design principles and risk introducing distortions. Sustained efforts are therefore needed to build a more durable revenue base over time, including through single market–enhancing reforms that support sustainable revenues—such as Business in Europe: Framework for Income Taxation (BEFIT)—and through complementary approaches that draw on returns from EU investment in European public goods, including cross-border energy infrastructure.

A Framework Grounded in Sound Tax Design and EU-Level Suitability

1. Candidate own resources can usefully be assessed against two core considerations: sound tax design and EU-level suitability.

- Sound tax design favors efficient bases, strong enforceability, and revenue that is meaningful and predictable at the level of the overall package. In the EU context, efficiency generally points to EU-wide, cross-border bases or instruments that internalize clear externalities. Levies on gross bases—such as turnover, digital services, or financial transactions—tend to tax inputs repeatedly, distort production structures, and disproportionately penalize cross-border supply chains, running counter to the principles of the single market. Enforceability is strongest where the base is supported by harmonized rules and centralized monitoring systems, and weaker where the base is mobile or relies on uneven national reporting. Because EU own resources are often necessarily narrower than national tax bases, effectiveness and fairness should be judged at the package level—through a balanced mix that avoids systematic disadvantages and limits reliance on any single shrinking base.
- EU-level assignment is appropriate when subsidiarity is satisfied, and incentive effects reinforce EU priorities. This applies particularly where cross-border spillovers are central or where the underlying instrument is already governed at EU level, making these bases a natural foundation for the own resource system.

Implications for the New Own Resources Package for the Next MFF

2. The Commission's July proposal on the package of new own resources provides a useful anchor for the discussion. It combines revenues from EU-governed instruments—such as the ETS and CBAM—with targeted levies on e-waste and tobacco excise duty and a corporate-based contribution, to form a single financing package (Table III.1). This package approach helps balance key objectives—economic efficiency, administrative feasibility, and sufficiently diversified and stable revenue—while recognizing the constraints of any single instrument.

3. EU-governed instruments offer the strongest near-term foundation. Revenues from the Emissions Trading System (ETS) and the Carbon Border Adjustment Mechanism (CBAM) internalize

cross-border externalities, rely on established EU monitoring and compliance systems, and align directly with EU policy priorities—performing strongly across efficiency, enforceability, and EU-level suitability. These features make them both economically sound and institutionally well suited for EU-level financing. Securing a larger share of revenue from these EU-governed bases than currently envisaged would better reflect their economic logic and the EU's central role in governing them. ETS and CBAM together are expected to generate about €11 billion annually (the Commission's estimate), and raising the ETS call rate from the proposed 30 to, for example, 50 percent—could increase revenues by a further €6–7 billion.

4. Targeted bases can contribute meaningfully where revenue potential and administrative feasibility align. Instruments such as the proposed e-waste contribution or the assignment of tobacco excise revenues are estimated to raise significant revenue. Overall, these instruments are suitable contributors based on their revenue scale, policy alignment with shared EU goals, and administrative feasibility. However, their effectiveness depends on implementation capacity—especially improved harmonization and data quality where national reporting is uneven.

5. The system ultimately needs durable, broad-based resources. Corrective instruments, including climate- and environment-related sources, are expected by design to decline with policy success. A system leaning on them alone would face recurrent financing pressures, and repeated, contentious negotiations each time needs grow. A new own resource anchored in persistent economic activity could ease that cycle and lend the revenue base greater predictability. Corporate-profit-related resources offer this potential in principle. However, the most rigorous options face deep political and implementation obstacles, while more readily feasible alternatives carry their own significant limitations.

6. Turnover-based levies, the most durable component of the proposed package, however, does not meet core design criteria. Turnover-linked, such as Corporate Resource for Europe (CORE), are modest in scale but rest on a base that could generate cascading distortions and disproportionately affect lower-margin and longer, cross-border production chains, potentially undermining single market neutrality. Similar structural weaknesses limit the case for other gross-basis levies that are sometimes proposed as alternatives.

7. Given near-term constraints, higher call rates on robust bases provides a pragmatic near-term solution, while continued efforts to develop more durable revenue sources remain essential. Raising the EU share (call rate) on high-quality bases—such as the ETS and EU-harmonized VAT—can deliver additional resources without introducing new distortions or requiring complex new tax architectures. The VAT-based own resource is among the EU's most harmonized and administratively robust bases and can generate meaningful revenue with modest call-rate adjustments. These steps can reinforce the EU's debt-servicing capacity and make agreement easier by scaling up what already works. Given its large base, a higher VAT own resource call rate could generate meaningful additional revenue: raising it by 0.1 percentage point (from the current 0.3 percent) could yield about additional €8 billion, or equivalently about 0.05 percent of EU GNI.

Building a Durable Pillar and Strengthening The EU Financing Model over Time

8. Business in Europe: Framework for Income Taxation (BEFIT) stands out as it aligns closely with the underlying design principle of a sound own resource. By allowing companies operating in multiple member states to rely on a single tax base for preparation and filing, BEFIT would reduce compliance and administrative costs and strengthen single market efficiency. While it has not yet reached political agreement and discussions remain technical, making timely delivery for the next MFF, advancing BEFIT holds long-term benefits for the single market and has the potential to underpin a more stable EU budget.

9. Over the longer term, the EU's financing model can be further strengthened by capturing returns on EU investment in European public goods (EPGs), such as cross-border energy infrastructure. A more self-financing approach—linking EU-level investment to revenue streams through user charges or returns on investment—could better align financing with the cross-border nature of the resulting benefits, particularly in areas such as electricity infrastructure where integration externalities are central. This would require some form of EU ownership of interconnectors, potentially through an EU-level Transmission System Operator, representing a significant institutional leap. Such mechanisms are therefore best viewed primarily as investment instruments that can help strengthen the EU's financing model over time, rather than as a core source of budget revenue at this stage.

Table III.1. EU Budget New Own Resources: Commission Proposal and Considerations

Instrument	Estimated annual yields 1/	Design	
ETS1	€9.6 bil	30% ETS1 revenues	EU-governed base with harmonized administration and strong policy alignment. A higher call rate could be justifiable.
CBAM	€1.4 bil	75% CBAM revenues	EU-governed base with harmonized administration and strong policy alignment. Limited revenue potential, and implementation complexity.
E-waste	€15 bil	Uniform rate on weight of uncollected electrical/electronic waste	High revenue potential, but effectiveness depends on improved data quality and enforcement.
Tobacco excise duty	€11.2 bil	15% of the EU-defined minimum rate	Feasible under existing framework; meaningful and stable revenue source.
Corporate Resource for Europe (CORE)	€6.8 bil	Lump-sum levy on firms with turnover > €100 mil	Distortionary; compounds through production stages and disproportionately burdens firms with low margins and complex cross-border production structure—potentially undermining single market neutrality.

1/ The European Commission estimates.

Annex IV. Implementation of IMF FSAP Recommendations

	Recommendation	Authorities	Timing[1]	Status
	Systemic Risk Analysis			
1	Strengthen systemwide financial risk monitoring on a cross-country and cross-sectoral basis and conduct systemwide stress tests, including bank and nonbank sectors.	ECB, ESRB, ESMA, EIOPA, EC	MT	Work on revising the ECB's internal macroprudential country-risk rating framework is progressing, with a stronger focus on stock vulnerabilities and integrating an explicit assessment of the probabilities and severities of potential trigger events. The ESRB will provide macroprudential policy advice to non-EA EU countries, in close collaboration with the ECB. It will refine its macroprudential stance metrics and extend them to cover the NBFI sector. The ECB and ESRB, in collaboration with NCAs, have enhanced cross-sectoral financial risk monitoring by examining banks' exposures to the NBFI sector (report, 2026). Leveraging on granular data, the analysis focuses on bank funding from NBFIs, banks' credit exposures to NBFIs, and banks' intermediation role in derivatives and repo markets. It highlights the need for ongoing assessment of risks from bank-NBFI interconnectedness. The ECB is developing a monitoring tool to evaluate the cross-country dimension of these linkages. The ESRB has initiated top-down systemwide stress testing covering the EU financial system, alongside efforts to address operational challenges and expanding the access to the necessary data. This will allow the ESRB to identify vulnerabilities at an early stage by enabling it to map how specific shocks could propagate within the EU financial system, across sectors, markets, and counterparties. Euro area authorities are closely following the ongoing exercises in France (BdF, ACPR, AMF) and the UK. In parallel, the ECB is advancing its work on systemwide stress testing, which will be the starting point for the ESRB Temporary Task Force on System-Wide

	Recommendation	Authorities	Timing[1]	Status
				Stress Test Model Development (TTF). Currently, the ECB model, which covers banking, insurance, and investment funds, is being expanded to account for the risks emerging from repo and interest-rate derivatives markets. As part of its ongoing work on liquidity stress testing for funds, ESMA has started work to include cross-currency aspects into the fund stress test framework. ESMA and EIOPA are both active members of the new ESRB TTF, which should foster the inclusion of cross-sectoral effects into the system-wide stress testing framework. ESMA is also performing regular bottom-up stress tests on money market mutual funds (MMFs), in cooperation with the ECB and the ESRB. The stress scenarios are not cross cross-country and cross-sectoral, but the nature of MMF themselves and their role in the short-term funding of credit institutions make the sector relevant from a systemic perspective. Apart from stress testing, ESMA is coordinating a regular risk assessment of leveraged alternative funds with the NCAs. This includes risks related to the use of leverage in relation to fire sales, liquidity, or contagion to other market participants through the counterparty channel. EIOPA regularly stress tests the resilience of Insurance undertakings and Institutions for Occupational Retirement Provision (IORPs) operating in the European Economic Area (EEA) against adverse market developments. In line with its mandate and EIOPA board of Supervisors decision, EIOPA conducts stress test exercises for both the insurance and IORP sectors on an alternating basis every 3 years. Scenarios are identified in cooperation with the ESRB based on the EIOPA and ESRB's assessment of prevailing sources of systemic risks identified for the EU financial system.

	Recommendation	Authorities	Timing[1]	Status
				Recent iterations complemented the assessment of the capital position of insurers (2021 and 2024 exercise) and IORPs (2025 exercise) with the assessment of the liquidity position of the two sectors under stress. The mainly microprudential stress test framework has been enriched by allowing the application of management actions in reactions to the prescribed shocks, allowing for the assessment of potential spillovers to other sectors. EIOPA is also finalizing the development of a top-down model to run stress test based on the regular Solvency II reporting with the aim of running its first top-down explorative exercise on the insurance sector in 2026. EIOPA is monitoring on a quarterly basis the liquidity position of insurers through a specific exercise based on Solvency II reporting and yearly ad-hoc data collection.
2	Enhance data collection and powers for automatic and timely sharing of financial stability data including for nonbank financial institutions and transaction-level data.	EC	MT	Two horizontal measures were introduced recently: the Better Data Sharing Regulation (EU) 2025/2088, promoting the timely sharing of data among authorities, and the revision of the Regulation (EC) No. 2533/98 concerning the collection of statistical information by the ECB, opening access to ECB statistical data for other authorities. Additional improvements are under development on integrated reporting concerning asset managers, funds, transactions, and the insurance sector. These initiatives need to be followed by the implementation of technical infrastructure, and there are several ongoing initiatives by the European Supervisory Authorities (ESAs) to enhance their role of data hubs. The ESRB has recently significantly expanded its access to data by obtaining permanent access to supervisory banking data reported under Finrep/Corep templates, crucial

	Recommendation	Authorities	Timing[1]	Status
				for the development of the system-wide stress test and for early identification, monitoring and addressing systemic risks. The ESRB is now focusing efforts on obtaining access to additional granular datasets (data reported under Solvency II and under MiFiR/MiFiD) that will also contribute to fostering financial stability through risk monitoring.
3	Continue enhancing macroprudential stress tests that account for the interaction between bank solvency and liquidity risk, in particular through margin calls, business risk, and credit sensitive funding.	ECB	MT	Recent developments on the top-down macroprudential Banking Euro Area Stress Test model aim at better capturing the feedback loop between banks' solvency and their funding cost, notably on the wholesale markets. Further work is envisaged to better capture the impact of liquidity stress on banks' funding availability and funding cost, affecting banks' solvency position, their credit supply and ultimately the real economy. Although the above applies to a bank-only framework, work on spillovers between banks and NBFIs will also contribute to the assessment of resilience of the banking sector from a macroprudential perspective. In particular, the work on systemwide stress testing focuses on the interactions between solvency and liquidity risk, and the contagion across various sectors and channels. Such work features, among others, deep dives into the role of derivatives market and short-term funding markets (repos in particular), which might generate pressures both from a solvency perspective (counterparty credit risk) and from a liquidity one (margin calls and collateral calls).
	Financial Sector Oversight—Micro- and Macroprudential			
	Banking			
4	Reduce the SSM's reliance on national legislative frameworks.	EC	MT	As part of the EC work on competitiveness of the banking sector, a targeted public consultation has been

	Recommendation	Authorities	Timing[1]	Status
				launched in February 2026 to gather evidence and feedback from stakeholders on a broad number of issues. The consultation concluded on 19 April 2026. Together with contributions prepared by the ECB-SSM (see proposals from the High-Level Task Force on Simplification published in March 2025) and by the EBA (see Report on the Efficiency of the Regulatory and Supervisory Framework of October 2025), it will contribute to the Commission reflections on the EU banking landscape, including its regulatory framework. In this context, the possible integration of certain provisions from the Directive (CRD) to the Regulation (CRR), thereby also addressing the FSAP recommendation, is currently being assessed.
5	Improve governance of budgetary processes, further delegate decision-making, and align resources to current and expected future workload.	ECB	MT	The ECB has updated its budget planning process ensuring that Banking Supervision (BaSu) leadership are consulted at an earlier stage. Specifically, a new step has been introduced into the process, requiring direct input from the ECB BaSu leadership team before consultation with individual BaSu business areas (BAs). The updated process ensures strategic guidance is captured early, enhancing prioritization and alignment with supervisory needs. The ECB's 2025 report on "Streamlining Supervision, safeguarding resilience" details how the ECB is taking further steps in delegating decision making: More than half of all supervisory decisions are now taken at senior management level, with plans to extend delegation to additional areas such as mergers, divisions, and qualifying holdings. In addition, a risk-based strategy for common procedures, now covers 90 percent of common procedures,

	Recommendation	Authorities	Timing[1]	Status
				focusing resources on more complex cases and enabling faster processing for straightforward applications. The ECB is also further automating and digitalizing its FAP processes enhancements to tools, such as the IMAS Portal to streamline information requests and submissions.
6	Review capital requirements for EU internationally active banks and ensure that they are aligned with the Basel standards.	EC	MT	As part of the EC work on competitiveness of the banking sector, a targeted public consultation has been launched in February 2026 to gather evidence and feedback from stakeholders on a broader number of issues, including the inherent complexity of the capital requirements and the existence of multiple stacks. The consultation concluded on 19 April 2026. Together with contributions prepared by the ECB-SSM (see proposals from the High-Level Task Force on Simplification published in December 2025) and by the EBA (see Report on the Efficiency of the Regulatory and Supervisory Framework of October 2025), it will contribute to the Commission reflections on the EU banking landscape, including the future design and content of its prudential framework. Any revision of the capital requirements and possible amendments to the transitional provisions and current deviations from the Basel standards will be assessed in the context of that work. The Commission has reiterated its commitment to the Basel standards but also stressed the importance of a global level playing field. It has made clear that simplification should not be understood as deregulation, stressing the importance of credible capital levels for the stability of the financial system and competitiveness.
7	Make supervisory process more risk-focused, consider sovereign risk concentration	ECB	MT	The ECB's 2025 report on "Streamlining Supervision, safeguarding resilience" outlines its ongoing and upcoming

	Recommendation	Authorities	Timing[1]	Status
	when setting pillar 2 capital add-ons, and utilize the full panoply of corrective and sanctioning powers.			initiative for making supervisory more risk focused. The report recalls the recent introduction of a new Risk Tolerance Framework and revised P2R methodology, which increase the risk-based nature of supervisory processes. The report also provides details on how the ECB is working toward more systematically using the full supervisory toolkit – including a new tiered approach to following up on supervisory findings.
8	Ensure that legislation explicitly allows for early activation of the countercyclical capital buffer (CCyB) even when cyclical systemic risks are not yet elevated.	EC	ST	Further discussion on this matter is expected to be included in the upcoming Report on the Competitiveness of the EU banking sector, which will tackle *inter alia* the undue complexity in the macroprudential framework for banks. Any further revision of CRD/CRR will give due consideration to this aspect. The Commission notes that a majority of MS uses a non-zero CCyB when cyclical risks are not yet elevated even under the current legislative framework (Joint ESRB and ECB report from January 2025).
9	Ensure that releasable capital buffers are in place and consistently used across EA countries, including through the use of recommendations or top-up powers.	ESRB, ECB	MT	In the current discussions on simplification of EU regulation of the financial sector, the ESRB continues to advocate strongly for maintaining resilience, including at least maintaining the current level of releasable buffers. From the ECB's perspective, ensuring that releasable capital buffers are effectively operational and consistently applied across euro area countries is essential to safeguard the smooth implementation of macroprudential policy and preserve financial stability. In this context, the ECB regularly monitors risks that are relevant for macroprudential policy, assesses the appropriateness of macroprudential policy stances in euro area countries, including the use of releasable buffers, and shares its assessment with national

	Recommendation	Authorities	Timing[1]	Status
				macroprudential authorities and internal stakeholders via internal publications.
10	Streamline the EU governance procedures for activating macroprudential measures.	EC	ST	The envisaged approach to the streamlining of procedures for the activation of macroprudential measures, in particular those related to macroprudential risk weight provisions in CRR to make them more proportionate and less burdensome from an operational point of view is expected to be further discussed in the upcoming Report on the Competitiveness of the EU banking sector. Any further revision of CRD/CRR will give due consideration to this aspect. Discussions are also under way vis à vis the macroprudential measures regarding non-banks intermediation sector. National macroprudential authorities and Eurosystem proposing the elaboration of a coordination framework overseen by ESMA in collaboration with the ESRB based on a formalized reciprocation procedure aiming at addressing systemic risk stemming from entities operating cross-border while preventing inaction bias, and regulatory arbitrage.
11	Harmonize the methodology for implementing O-SII buffers, while allowing some flexibility to reflect country specific issues.	EC	MT	The envisaged approach on the review of the O-SII identification framework and the calibration of the O-SII buffer rates to reduce the observed heterogeneity in the O-SII buffer setting across Member States is expected to be further discussed in the upcoming Report on the Competitiveness of the EU banking sector. More harmonization of the EU O-SII framework, including observing banks' systemic importance in the context of the Banking Union or the Union as a whole, rather than purely from national perspective, is considered an essential topic for the reform of the macroprudential framework. Any further revision of CRD/CRR will give due consideration to this aspect.
	Insurance			

	Recommendation	Authorities	Timing[1]	Status
12	Provide EIOPA with stronger powers to foster supervisory convergence on internal models and policyholder protection risks from cross-border insurance.	EC, EIOPA	ST	The recent Solvency II review aims to strengthen supervisory cooperation and convergence through more structured information-sharing for significant cross-border business and additional EIOPA powers in cross-border cases, including binding mediation, joint on-site inspections, and, in certain cases, disclosing names of the undertakings concerned. The revised framework will be fully implemented by January 2027, although will not fully address the FSAP recommendation. In parallel, the EC's targeted 2025 consultation on the integration of EU capital markets gave EIOPA and its Members an opportunity to reflect on further supervisory enhancements. In its response, EIOPA identified key challenges and proposed a number of concrete improvements. Within the current framework, EIOPA initiated a substantial exercise to prioritize its resources for internal model activities in response to rising requests for technical assistance. Within existing resources to further reinforce its work in this area, EIOPA engaged with Members to recruit additional Seconded National Experts (SNEs) and two already started since the conclusion of the FSAP EIOPA will continue to explore further secondment opportunities with Members to strengthen the implementation of supervisory convergence.
13	Implement a minimum harmonization framework for Insurance Guarantee Scheme across member states to protect policyholders.	EC, EIOPA	MT	Article 98 of the Insurance Recovery and Resolution Directive (IRRD) requires the Commission to submit a report to the European Parliament and the Council on the appropriateness of minimum common standards for insurance guarantee schemes (IGS) in the Union, by 29 January 2027. If considered appropriate by the Commission, this report may be accompanied by a legislative proposal.

	Recommendation	Authorities	Timing[1]	Status
				The work for the timely preparation and delivery of the report is ongoing. Following a call for Advice by the Commission in August 2025, EIOPA is preparing its advice, which is expected to be delivered by the end of August 2026. In parallel, the Commission is engaging with a various range of stakeholders to seek their views on the appropriateness of minimum common standards for IGSs. At this stage, it is too early to assess the conclusions of the report. EIOPA is supporting the Commission by providing input to the Call for Advice. The activities will be conducted under the steer of the Standing Committee on Risks and Resilience (prior to that, it was under the Risks and Financial Stability Committee) in conjunction with the IRRD's activities. A public workshop was held on 4 February 2026, followed by a public survey. Stakeholders provided input by 27 February 2026. On 5 May, EIOPA launched a public consultation on the draft technical advice, open until 26 June 2026.
14	Ensure EIOPA is adequately resourced for the significant new permanent tasks it has assumed through legislative reform.	EC, EIOPA	I	EIOPA's Management Board established a Task Force in 2025 to examine the existing funding model and propose changes. Based on the work of the Task Force, EIOPA's Board of Supervisors endorsed a set of concrete proposals, which were subsequently communicated to the Commission for consideration. The Commission's proposal for the multiannual financial framework 2028-2034 included provision for a possible significant expansion of permanent tasks for EIOPA resulting from legislative reforms.
	Investment Funds and Capital Markets Union			
15	Reform the MMF Regulation in line with international standards.	EC	ST	The Commission services have been conducting work following up on the Commission's 2023 report on the MMF

	Recommendation	Authorities	Timing[1]	Status
				Regulation which, while confirming that the EU legal framework for MMFs works well, including in times of stress, had highlighted areas for further assessment, including liquidity. The Commission published its analysis on May 11*th* 2026, including additional guidance to the market in the form of FAQs.
16	Introduce a single reporting mechanism for fund-level data and centralize data collection at ESMA.	EC, ESMA	MT	The latest revisions of the UCITS (Art. 20b) and AIFM (Art. 69a) Directives require ESMA to prepare a report by 16 April 2026 on the development of the integrated collection of supervisory data, with a focus on how to: (a) reduce areas of duplication and inconsistencies between the reporting frameworks in the asset management sector and other sectors of the financial industry; and (b) improve data standardization and efficient sharing and use of data already reported within any Union reporting framework by any relevant competent authority, at Union or national level. ESMA is currently finalizing the report where it considers various options for a centralized collection system at EU level, as outlined in ESMA's discussion paper on the integrated collection of funds' data of 23 June 2025. ESMA will also take this recommendation into consideration in the context of the AIFMD review L2 work – to start in Q2 2026 at the earliest. In addition, the market integration proposal amends Regulation (EU) 2019/1156 to mandate ESMA to develop a data platform for the cross-border marketing of investment funds. ESMA is supporting ongoing efforts toward implementing this recommendation, which is closely aligned with one of the Simplification and Burden Reduction (SBR) flagship projects on single fund reporting.

	Recommendation	Authorities	Timing[1]	Status
17	Introduce a more structured approach to stress testing at ESMA and systemic risk monitoring and further develop system-wide stress testing.	ESAs, ESRB, ECB, EC	MT	The ECB is currently supporting ESMA with its preparation of an internal stress test for investment funds. Specifically, the ECB will contribute by designing a suitable scenario for such an exercise and will also be ready to provide analytical support by sharing best practices and material (e.g., codes) for investment funds' stress testing. Moreover, the latter will be subject of discussion and further developments in the context of the ESRB TTF. See also the response to recommendation 1.
18	Introduce compulsory supervisory colleges and consolidated supervision for large cross-border asset management groups.	EC, ESMA	MT	In the Market Integration and Supervision Package of December 2025, the Commission proposed to introduce a mandatory, at least annual review of large asset management groups, to be conducted by ESMA in cooperation with the relevant national competent authorities, with a view to identifying and addressing divergent, duplicative, redundant, or deficient supervisory practices, based on the analysis of available data, information and documentation.
19	Empower ESMA to top-up national measures (including leverage limits and liquidity requirements) for leveraged investment funds deemed to pose systemic risk and enforce cross-border reciprocation.	EC, ESMA	MT	Discussions are under way vis à vis the macroprudential measures regarding the NBFI sector. National macroprudential authorities and Eurosystem proposing the elaboration of a coordination framework overseen by ESMA in collaboration with the ESRB based on a formalized reciprocation procedure aiming at addressing systemic risk stemming from entities operating cross-border while preventing inaction bias and regulatory arbitrage
20	Strengthen ESMA's institutional and governance arrangements for supervision—including amending its regulation to bestow a: (i) a wider range of supervisory powers; and (ii) a sustainable funding framework—before expanding	EC, ESMA	MT	On 4 December 2025, the Commission adopted the Market Integration and Supervision Package (MISP) that aims to remove barriers to capital markets integration. In the area of supervision, the package proposes to enhance ESMA's role by strengthening existing supervisory convergence tools and by transferring

	Recommendation	Authorities	Timing[1]	Status
	its direct, risk based supervisory mandate.			direct supervisory competences over large, systemic market infrastructure and CASPs to ESMA. ESMA's governance structure, supervisory responsibilities, and powers as well as its funding structure will be reviewed, to encourage agile and independent decision-making and the appropriate resources (mainly fee-funded) to match its new responsibilities. The proposal now needs to be adopted by co-legislators. Discussions in Council and Parliament are gaining traction.
	Payments System			
21	Review and augment resources of the TARGET Services oversight team, apply more forward-looking interventions to anticipate emerging risks and ensure oversight findings are addressed on a timely basis.	ECB	I	The resources for the oversight of TARGET Services have been extended as of 2026 as the result of a broader effort to increase the resources for the Oversight Division. The Oversight function extended the monitoring and assessment of system performance and operational effectiveness indicators (incident trend, evolution of KPI breaches, time to defect resolution, etc). Deterioration trends in these indicators are taken into consideration when applying a risk-based prioritization of oversight activities. Horizon scanning is also used to identify emerging risk/themes (e.g., cyber risk exposure, cyber dependency, quantum risk, frontier AI risk) and prioritize initiatives and forward looking interventions based on the result of this exercise. Additionally, for the specific field of cyber resilience, the Oversight function relies on sectoral heatmaps and peer comparison dashboards internally elaborated from biannual cyber security survey. Oversight judgment is also applied on these quantitative early warning indicators to support the prioritization of oversight activities. In addition, the Oversight function analyses the scenarios used by the

	Recommendation	Authorities	Timing[1]	Status
				operator in testing activities to further inform its risk assessment and prioritization. As concerns the timely compliance with oversight findings, a rating scale was implemented in 2026 according to which each oversight recommendation is assigned a criticality rating of *high*, *medium*, or *low*, representing the priority that the TARGET Services operator should give to addressing it in view of the recommendation's potential impact on the safety and efficiency of TARGET Services and the urgency of implementing corrective actions. The Oversight function has a mechanism in place to regularly monitor and bi-annually assess the progress of implementation of recommendations. Escalation is applied in case of repeated delays in addressing oversight findings, in particular the ones with high criticality.
22	Strengthen procedures to identify and address potential conflicts of interest between the ECB's role as operator and overseer of TARGET Services, including by separating functions into different directorates.	ECB	ST	Procedures to address potential conflicts of interest between the ECB's role as operator and overseer of TARGET Services have been further strengthened in the second half of 2025 in the context of the update of the mandate for the Market Infrastructure and Payments Committee (MIPC). The updated mandate as approved by the Governing Council in Q4/25 sets out the following: "*For Eurosystem oversight topics, only MIPC members with responsibility for oversight are present and receive related documentation. Discussions and formulation of conclusions in this case are steered by the senior manager of the ECB with responsibility for oversight*. "
	Cybersecurity			
23	Review the regulatory framework for any gaps in the ability to fine non-cooperating critical third-party providers (CTPPs), particularly for non-compliance with the ESA's	EC	MT	No action is envisaged at this time.

	Recommendation	Authorities	Timing[1]	Status
	recommendations made under the DORA oversight framework.			
24	Strengthen the oversight of financial market infrastructures (FMIs) where the ECB is the lead overseer by executing on-site examinations of the cybersecurity control environment.	ECB	ST	On-site examinations of the cybersecurity control environment are foreseen, although have not been initiated yet.
25	Accelerate the development of cybersecurity risk oversight capacity at the ESAs in the context of DORA implementation.	EBA, ESMA, EIOPA	ST	The EU-SCICF is now operational, all the roles have been assigned, and the ESAs have conducted an emergency test. The EC has been informed of the remaining hurdles hindering effective development. To complement their current envelope of 30 posts, the ESAs have requested the EC, to allow for 9 additional posts (3 for each ESA) on their staffing envelope as of 2027. The need to strengthen staffing has been recognized, and the request has been approved, though in a manner adapted to the situation of each ESA. In one case, up to three new recruits will be possible, while in the other two, existing positions already included in the staffing envelope (for other activities) would need to be converted.
	AML/CFT			
26	Ensure AMLA, in close coordination with prudential and financial stability experts, adopts a holistic methodology to classify risk profiles and a harmonized AML/CFT supervisory methodology.	EBA, EC, AMLA	MT	On 30 October 2025, the EBA responded to the EC's Call for Advice (CfA) aimed at laying the groundwork for certain AMLA mandates. As part of this work, the EBA developed Regulatory Technical Standards (RTS) establishing a harmonized risk assessment methodology to be applied by AMLA and all EU AML/CFT supervisors when assessing risks associated with supervised financial institutions. The RTS introduces a single, EU-wide methodology, fundamentally reshaping supervisory risk assessments. The EBA

	Recommendation	Authorities	Timing[1]	Status
				developed the RTS in close internal consultation with prudential and financial stability experts, with direct involvement from ECB experts. The draft RTS were approved by the EBA Board of Supervisors prior to submission to the EC and AMLA, and were subsequently discussed and approved by AMLA's General Board, composed of all EU AML/CFT supervisors, on 10 December 2025. The Board approved the submission to the EC of the final reports containing two draft RTSs, which were subsequently submitted by AMLA to the Commission on 16 December 2025. One RTS under Article 40(2) Directive (EU) 2024/1640 ('AMLD') sets out a methodology for assessing and classifying the inherent and residual risk profile of credit institutions and financial institutions, as well as the frequency at which it shall be reviewed. This risk assessment methodology will be applied by all national supervisors to assess the risk related to each obliged entity under their supervision. The other RTS under Article 12(7) Regulation (EU) 2024/1620 ('AMLA Regulation') specifies the methodology for assessing credit institutions, financial institutions and groups of credit and financial institutions for the purposes of the selection for direct supervision by AMLA. The two draft RTSs are closely linked, as the risk assessment methodologies set out in both instruments are aligned. The two instruments are currently under review by the Commission's legal service. The work on developing a harmonized AML/CFT methodology is progressing. A comprehensive approach to merge the workstream with the development of supervisory guidelines, as per AMLD Article 40(3), is under preparation. This approach entails the development of a supervisory handbook under Article 8 AMLAR, which will complement the risk-based supervision guidelines by

	Recommendation	Authorities	Timing[1]	Status
				detailing supervisory practices. The financial sector will follow an accelerated timeline, with delivery to the AMLA GB of both the risk-based supervision guidelines and handbook by June 2027, while the non-financial sector will follow a phased approach, with delivery by July 2028. AMLA has started work on the testing, calibration and operationalization of risk methodologies underpinning supervisory decisions. These methodologies are being embedded in both direct and indirect supervision, ensuring convergence across Member States. AMLA is also building a holistic, data-driven risk framework, integrating supervision and financial intelligence through advanced analytics and a central data ecosystem. Overall, implementation is underway, with a trajectory toward a fully harmonized, risk-based supervisory system by 2028.
27	Foster stronger cooperation among national competent authorities (NCAs), AMLA, and third-country supervisors, including through AML/CFT supervisory colleges.	AMLA, EBA	MT	AMLA has implemented the recommendation to foster stronger cooperation among NCAs, AMLA and third-country supervisors, including through supervisory colleges, by embedding cooperation as a core element of its institutional and supervisory framework. At the governance level, AMLA's General Board in both its compositions provides a formal platform for coordination, exchange of views and adoption of cooperation-related decisions, supported by internal committees and working structures. Operationally, AMLA is developing harmonized EU-wide supervisory methodologies and has concluded consultation on Draft Implementing Technical Standards on cooperation within the AML/CFT supervisory system for the purposes of direct supervision.

	Recommendation	Authorities	Timing[1]	Status
				It shall conduct peer reviews and enable joint risk analyses and intelligence-sharing, including through the upgraded FIU.net. AMLA places AML/CFT supervisory colleges at the center of its supervisory model to coordinate cross-border oversight, support joint decision-making and resolve disputes, complemented by binding mediation powers. Its engagement in international fora such as the Financial Action Task Force (FATF) and the Egmont Group further strengthens cooperation with third-country supervisors. As of 1 January 2026, the EBA's stand-alone AML/CFT powers were transferred to AMLA. Prior to this transition, the EBA fostered cooperation among national competent authorities (NCAs), notably by developing—on its own initiative—the framework for AML/CFT colleges. This framework now serves as the foundation for colleges operating under AMLA's remit within the new AML/CFT framework. In parallel, the EBA sought to strengthen cooperation between AML/CFT and prudential supervisors through its guidelines on cooperation and information exchange under Directive 2013/36/EU. Going forward, the EBA will continue to promote supervisory cooperation, albeit in a different form by: 1) maintaining its role in facilitating cooperation with third-country authorities by assessing the equivalence of their confidentiality and professional secrecy regimes with EU requirements—often a prerequisite for participation in AML/CFT colleges or the establishment of MoUs. In this context, the EBA updated its *Guidelines on the equivalence of confidentiality regimes* (EBA/GL/2025/05), published on 22 December 2025; 2) exploring ways to enhance coordination across prudential, conduct, AML/CFT, resolution, and other

	Recommendation	Authorities	Timing[1]	Status
				authorities to reduce supervisory burden and overlapping requirements for financial institutions subject to multiple supervisory regimes. This work forms part of the EBA's broader efficiency initiative set out in its report on The Efficiency of the Regulatory and Supervisory Framework (EBA/REP/2025/26), published on 1 October 2025.
28	Make sure that AMLA takes an active role in harmonizing AML/CFT regulatory enforcement practices across the EA to ensure consistent compliance and reduce regulatory arbitrage.	AMLA	MT	AMLA implemented the recommendation to take an active role in harmonizing AML/CFT regulatory enforcement practices across the Union, by introducing a unified enforcement framework; this framework encompasses sanctioning powers, governance arrangements and procedural standards designed to ensure that supervisory decisions are consistent and predictable. A key step in this process has been the launch of a consultation on Draft Regulatory Technical Standards (RTS) concerning pecuniary sanctions, administrative measures, and periodic penalty payments. AMLA's planned deliverables for 2026 include the development of RTS on indicators for classifying the level and severity of AML/CFT breaches, criteria for determining appropriate sanctions or administrative measures, and a methodology for applying periodic penalty payments. In addition, AMLA will issue Guidelines on baseline amounts for pecuniary sanctions, calibrated to turnover, type of breach, and category of obliged entity. By 2028, breaches are expected to be addressed in a harmonized and proportionate manner throughout the Union. In parallel, AMLA is deploying indirect supervision tools to monitor national authorities and promote convergence in supervisory and enforcement approaches; this includes assessing how national supervisors conduct oversight, the measures and sanctions they apply

	Recommendation	Authorities	Timing[1]	Status
				and their compliance with supervisory requirements. AMLA will also identify vulnerabilities in national systems and develop methodologies, procedures, and action plans to enhance convergence. Furthermore, AMLA is preparing to intervene where national supervisors may have breached Union law or where non-selected entities engage in serious, repeated, or systematic violations.
	Financial Safety Nets and Systemic Liquidity			
29	Introduce a financial stability exemption for access to the Single Resolution Fund (SRF).	EC	ST	The final texts agreed by the co-legislators on the recent CMDI review did not include a change to the 8 percent min. total liabilities and own funds (TLOF) bail-in rule to access resolution funds, and such change was not part of the Commission's proposal on the CMDI review, either. The issue was addressed indirectly, through the set-up of a DGS bridge mechanism to bridge access to the resolution funds (Single Resolution Fund and national resolution funds for Member States not part of the Banking Union), when conditions and safeguards are met, as a solution to unlock additional funding. The Commission considers that introducing such a clause would not have sufficient political support, due to the member states' position on introducing such flexibility in the framework'.
30	Establish a European deposit insurance system, including loss sharing and strong funding backstops.	EC	MT	A targeted consultation on the competitiveness of the banking sector is currently ongoing that will inform the conclusions of the report of the Commission, which is expected to be published in the summer of 2026. The report will explore a possible way forward on a robust deposit insurance system while considering significant developments in the EU banking sector that have taken place since the Commission first tabled a proposal on

	Recommendation	Authorities	Timing[1]	Status
				this topic in 2015. Exploring a way forward is in line with the mission letter of Commissioner Albuquerque.
31	Put arrangements in place for the SRF to provide guarantees to support central bank liquidity to banks in resolution, including, if possible, an EU fiscal backstop.	SRB, Eurosystem, EC, ESM	I	Recent crisis cases in other jurisdictions have reconfirmed the importance of having specialised, readily available tools to address potentially significant liquidity gaps in resolution. Discussions at EWG level are currently ongoing. As part of the consultation for the 2026 report on the competitiveness of the EU banking sector report, the Commission has asked stakeholders about the importance of a predictable European mechanism ensuring the provision of liquidity in resolution to large banks, and how it could affect the bank-sovereign nexus and the reliance on national taxpayer sources. The Commission has asked about the desirable features of such a system. The conclusions of this consultation will be considered in the 2026 report. As of March 30, 2026, financially sound banks subject to a resolution scheme based on an open bank resolution strategy can access standard Eurosystem monetary policy operations, when coming out of resolution, provided they meet certain conditions.
32	Maintain high priority of work on resolution execution and address third-country securities law issues in bail-in.	SRB	ST	The SRB, in collaboration with NRAs, continues working to ensure resolution readiness and execution in particular by introducing the Multi-Annual Testing Programs (bank-led tests), performing SRB-led tests (dry-runs, deep dives) and continuously improving operational guidance for banks (e.g. see recent Operational Guidance for Separability and Transferability, Valuation Expectations and the Operational Guidance on the self-assessment by banks, Operational Guidance on resolvability testing etc.). The SRB is actively involved in the FSB High Level Task Force on Bail-in Execution, which took up its work in

	Recommendation	Authorities	Timing[1]	Status
				December 2025. It was established to explore avenues to ensure that the exercise of bail-in powers will be effective and enforceable across borders. Work also continues at the bank-specific level. A pilot deep dive on bail-in execution was conducted with a SRB bank at the end of last year, involving the bank and its legal counsel, and domestic and foreign authorities, including the SEC. The exercise has shown that specific types of bail-in mechanisms are executable under certain exemptions.
33	Further harmonize and ultimately centralize emergency liquidity assistance (ELA) arrangements.	ECB, EC, Eurosystem	ST	ELA continues to be provided by national central banks under the existing Eurosystem framework, with ECB oversight under Article 14.4 of the ESCB Statute.
34	Address the barriers to the provision of ELA to NBFIs, ensure appropriate oversight of relevant institutions, and operational readiness.	Eurosystem	MT	Barriers to the provision of ELA to NBFIs, as well as barriers to the appropriate oversight of relevant institutions have not been addressed yet. The ECB remains engaged in monitoring the NBFI sector and is continuing discussions on ways to increase its resilience and generally advocates for a macro-prudential approach toward NBFIs, including on liquidity mismatch.
35	Consider the conditions to allow for the expansion of the counterparty framework for systemwide support to be used in times of stress.	ECB	MT	The ECB is closely monitoring the NBFI sector and engaging in discussions on how to increase its resilience. In this vein, it remains important that any potential changes to accessing central bank liquidity, where considered appropriate, is carefully designed to not give rise to moral hazard, considering implications for the financial risk exposure of the Eurosystem.

[1] I: immediately; ST: short term = less than 1 year; MT: medium term = 1–5 years.

Annex V. Authorities' Response to Past Key Policy Recommendations

2025 Consultation Recommendations	Authorities' Reponses
Monetary Policy	
Since headline inflation is broadly at target, core inflation is slightly above 2 percent, and the output gap is mildly negative, a monetary policy stance close to neutral is justified.	The economy grew slightly faster than anticipated, while inflation declined somewhat more slowly than initially expected. Nonetheless, the output gap remained broadly closed, and headline inflation has fluctuated around the target since May 2022. The ECB has maintained the policy rate within the neutral range—estimated by staff to be 0 to 0.25 percent in real terms—since June 2025.
Quantitative tightening (QT) should remain gradual and predictable. The short-term policy rate is the primary instrument for implementing monetary policy, with QT operating in the background in a stable manner to reduce the ECB's footprint in the bond market.	QT has continued as planned and has had minimum impact on money market functioning. This is welcome as the transition into the ECB's new operational framework with a leaner balance sheet proceeds.
Fiscal Policy	
For countries with high debt and limited fiscal space, significant fiscal adjustments are needed to mitigate fiscal risks.	Fiscal policy in the euro area at the aggregate level tightened slightly in 2025. This reflects efforts for gradual fiscal adjustment guided by the EU fiscal framework in some countries, while some countries have utilized the flexibility allowed by the activation of national escape clause to address urgent security concerns.
Member states and the Commission should assess the consequence of increased defense spending on debt sustainability, modify adjustment path as necessary, and engineer a smooth exit from the escape clause.	While the Commission has underscored that flexibility should be temporary and tightly monitored, uncertainty about member states' defense-spending plans remains substantial, complicating the assessment of debt-sustainability impacts and leaving the analysis largely stylized rather than anchored in a most-likely scenario (as in the Commission's 2025 Debt Sustainability Monitor).
The EU budget, formerly known as the Multiannual Financial Framework, is an important policy lever to address shared challenges. The next MFF should increase its investment on European public goods in priority sectors including defense, energy security, and innovation. To support initial investment scale-up, the budget's financing framework should be enhanced with joint borrowing capacity paired with enhanced own resources.	The Commission's proposal for the next MFF is broadly in line with staff recommendations in shifting spending toward European public goods (defense, energy, innovation), streamlining programs, and introducing a more performance-based approach. However, it remains far less ambitious than staff had envisioned in terms of the overall scale and the role of common borrowing in the financing framework.
Financial Sector Policies	
Authorities should closely monitor risks from the growing NBFI sector and strengthen preparedness to address liquidity stress	Supervisors have intensified monitoring, though a dedicated NBFI liquidity framework remains under development.

2025 Consultation Recommendations	Authorities' Reponses
Facilitate better data sharing among EU and national authorities to improve system-wide risk monitoring.	Progress has been limited. While initiatives to improve coordination and reporting are ongoing, legal and institutional barriers continue to constrain data sharing, particularly for NBFIs, hindering system-wide risk monitoring.
Complete the Banking Union, including common deposit insurance and stronger resolution and liquidity arrangements.	CMDI reforms were agreed, enhancing resolution flexibility. However, EDIS and a fully operational common backstop remain outstanding.
Structural Reforms	
Deepen the EU single market, including through a 28th corporate regime, savings and investments union, labor mobility.	A range of initiatives have been launched to deepen the single market—including a proposal toward a 28th regime, the SIU December 2025 package, an EU securitization and supplementary pension proposals—aiming to reduce regulatory fragmentation and facilitate cross-border scale-up. A 28th corporate regime ("EU Inc")—a single, optional EU-wide company law allowing digital registration and operations under unified rules—is under discussion, following the Commission's proposal in March 2026. The savings and investments union (SIU) strategy aims to better connect household savings with productive investment, by removing barriers to cross-border investment and improving firms' access to capital markets. A Market Integration Package presented in December 2025 proposes to harmonize capital markets rules (converting directives to regulations to prevent national "gold-plating"), simplify cross-border trading and post-trade settlement, centralize supervision of key market infrastructures under ESMA, and support technology-based innovation in securities settlement. The EU securitization proposal (June 2025) and supplementary pensions proposal (November 2025) center on amending existing directives and regulations to increase take up, improve equal taxation treatment, and broaden the pan-EU investor base. Progress on services liberalization and intra-EU labor mobility—identified as significant binding constraints on productivity—has remained modest.
Enhancing energy security through increasing the reliance on renewables in line with goals of the "Fit for 55" package and better integrating the EU electricity market.	On renewables, the Commission has pursued measures to accelerate permit-granting for renewable energy projects and related infrastructure, proposed further permitting reforms in the European Grids Package on December 10, 2025, and launched consultations on the post-2030 renewable energy framework on March 20, 2026. While the Commission presented the European Grids Package in December 2025 and is advancing related initiatives in 2026, including the Electrification Action Plan, the Heating and Cooling Strategy, and the Strategic Roadmap for Digitalisation and AI in the Energy Sector, progress with energy market integration continues to face coordination challenges.
The EU would benefit from its continued advocacy for a stable, rules-based global	The European Parliament approved the EU–US agreement subject to conditions, though implementation timing and future

2025 Consultation Recommendations	Authorities' Reponses
trading system, removing remaining internal trade barriers, and deepening and diversifying its trade agreements.	US tariffs remain uncertain. The European Council endorsed the EU–Mercosur Partnership Agreement, with provisional application planned following Mercosur ratification, pending full EU ratification. The EU has also concluded free trade agreements with Australia, India, and Indonesia, which await signature and ratification.

Annex VI. Data Adequacy Assessment for Surveillance

Table VI.1. Euro Area: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating[1]							
A							
Questionnaire Results[2]							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Intersectoral Consistency	Median Rating
	A	A	A	A	A	A	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	A	A	A	A	A		
Granularity[3]	A		A	A	A		
			A		A		
Consistency			A	A		A	
Frequency and Timeliness	A	A	A	A	A		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.

[1]The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.

[2]The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).

[3]The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund are adequate for surveillance.
B	The data provided to the Fund have some shortcomings but are broadly adequate for surveillance.
C	The data provided to the Fund have some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund have serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Staff assesses the overall data quality to be adequate for Fund surveillance. The economic and financial statistics from the ECB and Eurostat are comprehensive and of high quality, and are provided in a comprehensive manner. The calendars of dates for main data releases are published well in advance.

Changes since the last Article IV consultation None.

Corrective actions and capacity development priorities None.

Use of data and/or estimates in Article IV consultations in lieu of official statistics available to staff. The staff report uses third-party indicators directly (e.g., Orbis, Bloomberg, LSEG Datastream) and indirectly through citing existing work.

Other data gaps. None.

Table VI.2. Euro Area: Data Standards Initiatives

By May 2026, 17 euro area countries had already adhered to SDDS Plus and 4 euro area countries adhered to SDDS.

STATEMENT BY MR. RICCARDO ERCOLI, EXECUTIVE DIRECTOR FOR ITALY, PORTUGAL, GREECE, MALTA, ALBANIA, AND SAN MARINO AND MR. JULIEN GUIGUE, ADVISOR TO EXECUTIVE DIRECTOR ON BEHALF OF THE EURO AREA AUTHORITIES
IMF EXECUTIVE BOARD MEETING
JULY 13, 2026

The authorities of the euro area Member States and the EU institutions are grateful for the open and fruitful consultation with staff and their constructive policy advice. The authorities are in broad agreement about the economic outlook, the need to ensure sustainable public finances, pursuing reforms and investments to boost productivity and competitiveness, deepening the single market and ensuring financial stability.

The euro area continues to face the consequences of Russia's war of aggression against Ukraine. At the same time, the war in the Middle East and the renewed energy price shock have increased downside risks to growth and upside risks to inflation. Progress in the Middle East, however, can reduce the need to consider severe scenarios. In this context, it remains essential to reduce strategic dependencies, strengthen energy security and accelerate the green transition. Pursuing reforms and investment to raise productivity, deepen the single market while seeking further trade diversification through advancing new free trade agreements and strengthening existing trading relationships is also important. The authorities are taking action to enhance the competitiveness and resilience of the European economy. To this end, the European Commission has put forward the "Competitiveness Compass," a strategic framework building on the findings and recommendations of the reports by Enrico Letta and Mario Draghi.

The euro area entered this period of heightened uncertainty with sound fundamentals, resilient institutions, well-capitalized banks and a strong policy framework, which continue to support confidence in Europe's capacity to adapt and respond. Bulgaria's adoption of the euro as of January 1, 2026, marks a further enlargement of the euro area after Croatia in 2023. The enlargement brings greater economic and financial stability, easier transactions, and deeper integration across Europe.

Economic Outlook and Risks

The authorities broadly share the Fund's overall assessment of the macroeconomic outlook. Growth is expected to remain positive—but weaker than forecasted before the war- and inflationary pressures have increased. As a net energy importer, the euro area is sensitive to the second energy shock in less than five years. Although mitigated by progress in energy sources and energy efficiency, the spike in prices still means higher energy bills for businesses and households, effectively diverting income out of the euro area. Consumer and business confidence have also been affected. Continued uncertainty surrounding our partners' trade policies and the ongoing reconfiguration of geopolitical and trade relationships could further weigh on confidence and activity.

The authorities assess the euro area's external position to be broadly in line with fundamentals. The assessment remains qualitatively unchanged from the previous year. It follows a 1 percentage point narrowing of the current account surplus in 2025 relative to 2024, accompanied by a slight appreciation of the real effective exchange rate. The narrowing has been underpinned by strengthening domestic demand in the euro area. We continue to assess that part of the surplus reflects temporary factors, the presence of multinational enterprises in the euro area, and policy gaps originating in jurisdictions outside the euro area.

Following the outbreak of the war in the Middle East, euro area inflation rose above the ECB's two percent medium-term target. Before the start of the war, euro area headline inflation had been around the target, at 1.9 percent in February. Since then, it rose to 3.2 percent in May before decreasing to 2.8 percent in June. Core inflation—excluding energy and food—stood at 2.4 percent in June. Domestic cost pressures continue to moderate mainly thanks to easing wage growth, reflecting the lagged impact of the earlier disinflation. As of now, there are no signs of second round effects of higher energy prices: negotiated wages are expected to increase by 2.6 percent in 2026 according to the ECB wage tracker (similar to before the start of the war), while long-term inflation expectations remain anchored. The June 2026 Eurosystem staff projections saw inflation increase to 3.0 percent in 2026, mainly driven by higher energy prices, before declining to 2.0 percent in 2028 as the energy shock fades. Against the backdrop of geopolitical tensions, the outlook for inflation is more uncertain than usual.

Macroeconomic Policies

In line with the commitment of setting monetary policy to ensure that inflation stabilises around the 2 percent target in the medium term, the ECB's Governing Council decided on June 11 to raise all three key interest rates by 25 basis points. With this decision, the ECB remains well positioned to navigate the current uncertainties. The Governing Council follows a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance. In particular, the interest rate decisions will be based on an assessment of the inflation outlook and the risks surrounding it, in light of the incoming economic and financial data, as well as the dynamics of underlying inflation and the strength of monetary policy transmission. The Governing Council is not pre-committing to a particular rate path. The normalisation of the Eurosystem's balance sheet initiated in late 2021 is proceeding at a measurable and predictable pace. The Governing Council stands ready to adjust all of its instruments within its mandate to ensure price stability and to preserve the smooth functioning of monetary policy transmission.

The authorities agree on the importance of maintaining medium-term fiscal sustainability and ensuring effective implementation of the EU fiscal framework. The authorities agree that energy-related measures should be temporary, targeted to the most vulnerable households and most affected businesses, in line with the EU fiscal framework, and support long-term decarbonization objectives. Member States should implement their agreed adjustment paths, with the authorities recognising that materially more ambitious adjustment could prove difficult under current conditions. The National Escape Clause has been introduced to accommodate the transition to a structurally higher level of defence expenditure, while ensuring debt sustainability. The scope of this escape clause may be broadened to accommodate energy security measures, while keeping the cap for deviations from the expenditure paths. Moreover, only new budgetary measures (decided after February 28, 2026) that strengthen the structural resilience of the European energy system and accelerate the transition away from fossil fuels will be considered for flexibility. Looking ahead, it will be important to adapt budgets to sustain the higher level of defence expenditure. Against a backdrop of strained public finances and pressure to extend support measures, fiscal policy should remain prudent and credible and aim at strengthening public spending efficiency.

Structural Policies

The authorities agree on the need for a coherent policy mix that addresses the current energy shock while accelerating the energy transition and strengthening resilience. In the near term, this includes prudent use of fiscal measures, the temporary State aid framework and improved monitoring of energy demand and supply conditions. At the same time, the current shock should reinforce, not delay, the transition to clean energy, as reflected in faster deployment of green technologies including electric vehicles and heat pumps. Beyond market-driven changes, structural support for decarbonization should remain anchored in the existing State aid and climate frameworks, notably Clean Industrial Deal State aid Framework (CISAF) and Climate, Energy and Environmental Aid Guidelines (CEEAG), and be complemented by competitively allocated EU instruments such as the Innovation Fund and the Hydrogen Bank financed through ETS revenues. The Grids Package is seen as particularly important to improve planning, financing flexibility and permitting, especially if accompanied by stronger support for cross-border energy infrastructure in the next MFF. The authorities take note of Staff's recommendation to create an energy blueprint.

The authorities take issue with Staff's assessment of the Industrial Accelerator Act (IAA) proposal, which gives insufficient consideration to the specific headwinds the EU and euro area face as regards critical supply chains and other disruptive forces in the global economy. There is agreement that the EU needs to simultaneously pursue productivity and competitiveness, economic security and decarbonization, whilst managing a number of trade-offs. While Staff focus on potential efficiency costs and trade risks, the authorities stress that the IAA's narrow sectoral focus limits costs in the short run while preserving resilience and decarbonization benefits in the longer run. The IAA pursues both economic security and decarbonization objectives via a number of measures targeted at a small number of strategic sectors where vulnerabilities and spillovers are most acute. By creating public sector demand for low-carbon EU industrial products, the IAA aims at providing long-term certainty, making investments in decarbonization technologies more secure and strengthening manufacturing capabilities—thus complementing diversification and research and innovation efforts.

The authorities also consider that deepening the single market remains central to Europe's resilience, productivity and ability to scale up innovative firms. The EU needs a larger non-bank financial sector to support equity financing. In this context, the authorities highlight ongoing work on the 28th regime corporate legal framework and on the implementation of the Savings and Investments Union Strategy (SIU). The Market Integration and Supervision Package aims to integrate and develop capital markets to provide the necessary scale for financing innovation and growth. Moreover, the supplementary pensions package seeks to improve pensions adequacy. Beyond the financial stability imperatives, completing the Banking Union remains essential to reducing financial fragmentation and improving firms' access to finance across the euro area. The Tech Sovereignty Package also calls for urgently boosting equity financing for high-growth and deep-tech companies as well as large infrastructural investments within the Single Market. The authorities agree on the need to act with speed and ambition in the field of digital finance. The AI Act provides a risk-based foundation for enabling innovation while building trust. The EU continues to support the rules-based multilateral trading system, and the authorities agree on the importance of an effective trade policy toolkit—and WTO reform—and the role of bilateral and plurilateral agreements in promoting diversification, predictability and economic security. They also concur on the importance of effective competition enforcement and note that the ongoing review of merger guidelines aims to modernise the framework, including through a more unified analytical approach while continuing to address market power effectively. In this context, preserving a level playing field and preventing regulatory or financial fragmentation across Member States remain essential to the effective deepening of the Single Market.

The implementation of the Recovery and Resilience Facility is drawing to a close and has yielded important lessons as regards simplification and streamlined conditionality. All

Member States are expected to submit payment requests in the autumn in view of the end-2026 deadline. Last plan revisions intend to address technical and implementation constraints while preserving ambition. Implementation remains uneven due to reform delays and administrative bottlenecks, creating some risks for full disbursement. As a result, short-term macroeconomic effects may be somewhat lower than previously expected, even if the medium- to long-term impact remains substantial, in particular through structural reforms. As regards the next Multiannual Financial Framework, the authorities note that discussions are progressing constructively with the shared objective of a timely agreement. The European Council has noted that an agreement before the end of 2026 would allow for the adoption of legislative acts in 2027, which is necessary to ensure that EU funding reaches beneficiaries without interruption in January 2028. Strengthening the revenue base, including through progress on new own resources, will be an important part of this work.

Financial Stability

The authorities agree that safeguarding financial stability requires continued vigilance and adaptation to evolving risks and financial innovation. Global financial stability risks are assessed as elevated, notably in view of structural changes in bond markets, the growing role of non-bank financial intermediaries (NBFI), concentration in global equity markets and the rapid growth of private credit, even though banks maintain strong profitability and robust capital and liquidity buffers, and corporate balance sheets are broadly sound. Authorities see merit in simplifying EU financial regulation and supervisory processes to enhance market integration and reduce undue complexity or compliance costs—provided that resilience and financial stability are maintained. Authorities also agree with preserving macroprudential buffers, with current levels seen as broadly appropriate, while recognising the need for Member States to adjust their stance, depending on national conditions. At the same time, current cyclical conditions do not point to a general case for broad-based additional tightening or release. Strengthening macroprudential oversight across the financial system remains essential. The system-wide stress test planned for 2028 is a key tool for assessing cross-sectoral risks and interconnectedness, and would support the continued efforts to monitor exposures, coordinating measures and policies, closing data gaps and sharing information. The authorities also noted stablecoin-related risks as currently contained but potentially growing, particularly through cross-border issuance and bank linkages, thus warranting closer monitoring—while recognizing the potential to address inefficiencies in cross-border payments by leveraging the benefits associated with distributed ledger technologies (DLT). Lastly, financial stability in the European Union is increasingly reinforced by robust AML/CFT reforms, as stronger anti-money laundering and counter-terrorist financing frameworks focussed on high-risk areas help safeguard the integrity, transparency, and resilience of the financial system.