

INTERNATIONAL MONETARY FUND

REGIONAL ECONOMIC OUTLOOK

EUROPE

Overcoming Europe's Policy
Drift: From Recognition to Action

2025
OCT



INTERNATIONAL MONETARY FUND

REGIONAL ECONOMIC OUTLOOK

EUROPE

Overcoming Europe's Policy
Drift: From Recognition to Action

2025
OCT



Cataloging-in-Publication Data
IMF Library

Names: International Monetary Fund, publisher.

Title: Regional economic outlook. Europe : overcoming Europe's policy drift : from recognition to action.

Other titles: Europe : overcoming Europe's policy drift : from recognition to action.

| Overcoming Europe's policy drift : from recognition to action. | Regional economic
outlook : Europe.

Description: Washington, DC : International Monetary Fund, 2025. | Oct. 2025. | Includes
bibliographical references.

Identifiers: ISBN:

9798229026635 (paper)

9798229026710 (ePub)

9798229026758 (Web PDF)

Subjects: LCSH: Economic forecasting--Europe. | Economic development--Europe. |
Economic conditions--Europe.

Classification: LCC HC240.A1 R445 2025

The *Regional Economic Outlook: Europe* is published once a year, in the fall, to review developments in Europe. Both projections and policy considerations are those of the IMF staff and do not necessarily represent the views of the IMF, its Executive Board, or IMF Management.



Publication orders may be placed online, by fax, or through the mail:

International Monetary Fund, Publication Services

P.O. Box 92780, Washington, DC 20090 (USA)

T. +(1) 202.623.7430

F. +(1) 202.623.7201

publications@IMF.org

www.IMFbookstore.org

www.elibrary.IMF.org

Contents

Executive Summary	v
--------------------------------	---

Overcoming Europe’s Policy Drift: From Recognition to Action	1
Europe Is Converging to a Mediocre Growth Trajectory.....	1
Inflation Is on Target in Advanced Economies but Eases Unevenly across Central, Eastern, and Southeastern Europe.....	6
Outlook and Risks.....	7
Headwinds from Uncertainty, Trade Tensions, and Euro Appreciation	7
Well-Known Barriers Are Holding Back Medium-Term Growth and Worsening the Fiscal Outlook.....	8
Steady Macro Policies for Near-Term Stability	10
Monetary Policy: An Anchor by Remaining Focused on Price Stability	11
Financial Policy: Steering through Uncertainty	12
Trade Policy: Judicious Use of Safeguard Measures and Expanding Internal and External Trade	13
Achieving Higher Growth: Moving from Recognition to Action	15
Securing Long-Term Fiscal Sustainability: Reforms and Adjustment.....	16
Overcoming Policy Drift.....	18
References.....	29

BOXES

Box 1. CESEE in a Turbulent World: Spillovers from EU and Global Shocks	21
Box 2. Stablecoins—Macro Financial Stability Implications for Europe	23
Box 3. A Three-Pillar Strategy for Raising Growth in Europe.....	26

FIGURES

Figure 1. Euro Area: Real GDP Forecast from WEO Vintages.....	1
Figure 2. Tariffs and Uncertainty	2
Figure 3. Interest Rates, Exchange Rates, Fund Flows, and Stock Returns.....	3
Figure 4. Frontloading and GDP Growth	4
Figure 5. Real Income and Household Saving	4
Figure 6. Purchasing Managers’ Index and Consumer Confidence	5
Figure 7. Labor Market.....	5
Figure 8. Inflation.....	6
Figure 9. Medium-Term Growth Forecast	8
Figure 10. Long-Term Growth Forecast	9
Figure 11. Elasticity of Labor Productivity to Density: European Union versus United States	10
Figure 12. Defense and Infrastructure Spending	10
Figure 13. Monetary Policy	11
Figure 14. Financial Policy	12
Figure 15. Trade Policy.....	14
Figure 16. Decomposition of GDP per Capita Difference with the United States	15
Figure 17. Fiscal Policy	17
Figure 18. Impossible Unanimity: Diverging Views on the EU Budget.....	19

Box Figure 1.1. Spillovers to Industrial Production versus GVC Participation.....	21
Box Figure 1.2. Contribution of EA Shocks to CESEE Industrial Production.....	21
Box Figure 1.3. Contribution of Commodity Price Shocks to Inflation after One Year.....	22
Box Figure 2.1. Stablecoins: Market Capitalization.....	24
Box Figure 2.2. Selected Economies: Credit Card Interchange Fees, 2024.....	24
Box Figure 2.3. Europe: Crypto Adoption.....	24
Box Figure 2.4. Selected Stablecoins: Composition of Reserve Assets, June 2025.....	24
Box Figure 3.1. Medium-Term GDP Impact of Closing 50 Percent of Prioritized Policy Gaps.....	26
Box Figure 3.2. Selected Reform Measures.....	26
Box Figure 3.3. Illustrative Simulations: Long-Term Gains from EU-Level Reforms.....	27
Box Figure 3.4. Ten Actionable Priorities in the Four Areas.....	27
Box Figure 3.5. IMF Proposal for MFF.....	28

Executive Summary

Europe has skillfully weathered many large shocks, but the lingering damage is starting to leave a mark. Growth momentum is fading toward a mediocre medium-term outlook. The boost from the frontloading of exports earlier this year is reversing as tariffs start to bite and bond markets are pricing in elevated risks amid continued uncertainty. Interest rate cuts and higher fiscal spending, including on defense, have so far failed to ignite private demand. The productivity gap to the United States remains large and is projected to widen. Domestically, well-known structural reform needs remain unaddressed. Prioritizing narrow national objectives over broader shared benefits and slow EU decision-making processes threaten to delay greater integration of Europe's capital, labor, and product markets. Moreover, growth reforms at the national level often lack domestic support. With growth and consolidation falling short, European countries' debt mountain could increase on average to 130 percent by 2040. Associated fiscal pressures demand significant fiscal consolidation.

In the near term, macroeconomic policies need to stay the course, safeguard hard-earned price stability, initiate fiscal consolidation, and preserve trade openness. Given the rise in international trade costs, Europe should broaden its trade relationships and promote multilateral cooperation. The key to sustainably higher long-term growth is overcoming the perilous policy drift in structural reforms. Solutions lie firmly within Europe's grasp. An intensive debate about reforms is now underway. But ambitious plans—ranging from cutting red tape to introducing a 28th regime—are at risk of being watered down.

Recognition of the urgency to change needs to be translated into forceful action. At the EU level, priority areas include dismantling the fragmentation in the single market, unlocking risk investment, scaling up the provision of European public goods, and maximizing agglomeration gains. If just the top third of the EU's production hubs could leverage agglomeration advantages associated with local availability of human capital and financing and R&D ecosystems as well as their US counterparts, aggregate EU labor productivity would be 8 percent higher. At the national level, boosting productivity requires reducing regulation, creating conditions conducive for innovation, and making labor mobile.

Reforms are difficult. Social dialogue and strategic communication can help overcome political divide and backlash from vested interests. Appropriate bundling, sequencing, and timing of reforms can garner broad support by spreading gains across society and countries. Nimble decision-making in the European Union would also help move decisions forward faster.

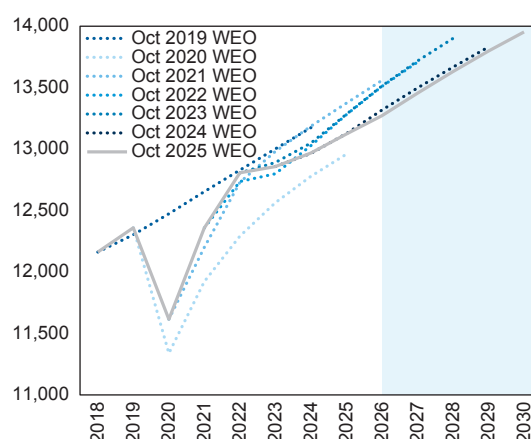
Overcoming Europe's Policy Drift: From Recognition to Action¹

Europe Is Converging to a Mediocre Growth Trajectory

Europe² has overcome large shocks but faces sobering medium-term challenges. In the past five years, the COVID pandemic and energy price shocks in the context of the Russian invasion of Ukraine have had large and imminent repercussions for Europe's economies. Since 2020, growth rates have zigzagged as shocks materialized, and policies responded. A feared deep growth slump was avoided, but growth has now settled on an output trajectory well below the pre-COVID-19 trend (Figure 1).

The changing global landscape is weighing on growth. Trade between the United States and the European Union—accounting for almost a third of global goods and services trade and 20 percent of EU exports—has become more costly. The October 2025 IMF forecast is based on the estimated effective US tariff rate on EU goods following the US-EU trade deal: at 16.3 percent³, a rate 4.3 percentage points higher than that anticipated in July and 15 percentage points higher than that in 2024 (Figure 2). Whereas the United Kingdom faces lower US tariff rates than the European Union, Switzerland and Serbia face higher tariffs. The euro area's nominal effective exchange rate has increased by 7.1 percent since March 2025. And substantial AI-related investments in the United States, China and to a lesser extent in Europe could signal large economic gains, but also carry the risk of sharp valuation changes in equity market globally if investments fail to generate the expected high returns (October 2025 *Global Financial Stability Report*, Chapter 1).

Figure 1. Euro Area: Real GDP Forecast from WEO Vintages
(Euro in billions)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: The GDP projection from past vintages before the latest vintage is based on the growth rate projection associated with the historical values in the year before the projection. WEO = *World Economic Outlook*.

¹ This report was prepared by a team comprising Burcu Hacibedel and Xiangming Fang with support and contributions by Claire Yi and Micol Galante, under the guidance of Sebastian Weber and supervision of Helge Berger, and Stephan Danninger.

² In this report, unless otherwise indicated, AE excl. CESEE includes Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Israel, Italy, Luxembourg, Malta, Netherlands, Norway, Portugal, San Marino, Spain, Sweden, Switzerland, and the United Kingdom. CESEE, for the purpose of this report refers to CESEE excluding Belarus, Russia, Türkiye and Ukraine, and includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Kosovo, Latvia, Lithuania, North Macedonia, Moldova, Montenegro, Poland, Romania, Serbia, Slovak Republic, and Slovenia. Throughout this report, AE and AE excl. CESEE is used interchangeably and always refers to the latter composition.

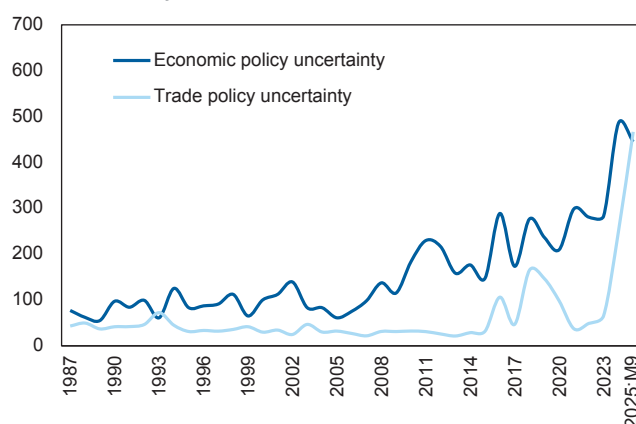
³ The effective tariff rate is a combination of respective sector weights in EU exports, headline tariff rates, and exemptions to those. Changes in the latter two have occurred since April and are possible going forward contributing to elevated uncertainty.

Higher US tariffs and a stronger euro are headwinds to growth and, together with high uncertainty, dampen firms' investment and market valuations. Firms with higher trade exposure to the United States and those with higher sensitivity to uncertainty have experienced significantly larger stock price declines since April 2 (Beyer, Tong, and Zhou 2025). Any financial sector repercussions would add to low productivity, an aging population, a shrinking labor force, and weak investment which already threaten the region's long-term prosperity. At the same time, long-term government bond yields have moved sideways or increased in many European countries as well as globally (Figure 3). Increasing long-term spending pressures and lack of sufficient near-term fiscal consolidation have left investors asking for higher compensation to lend.

Figure 2. Tariffs and Uncertainty

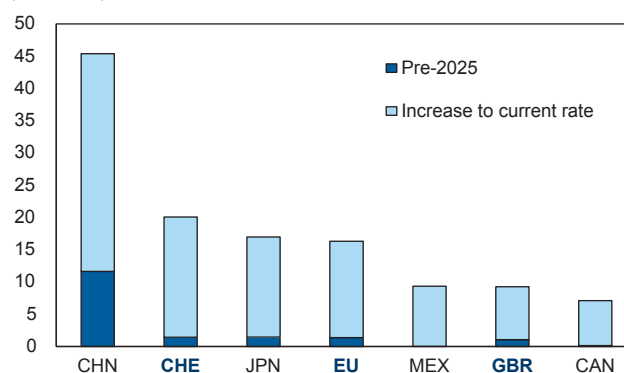
1. European Uncertainty

(Index, monthly)



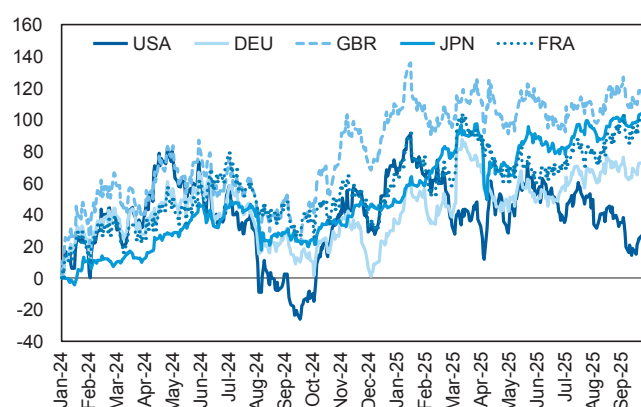
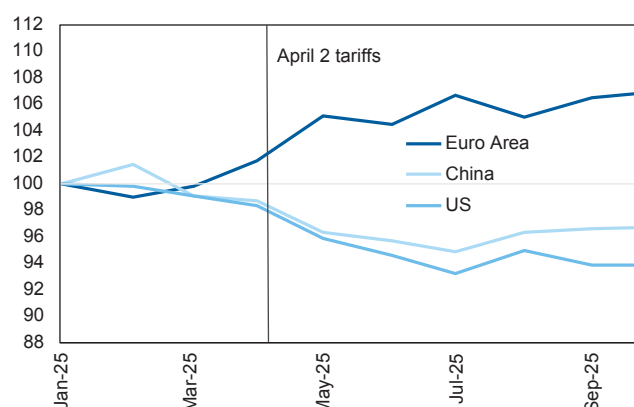
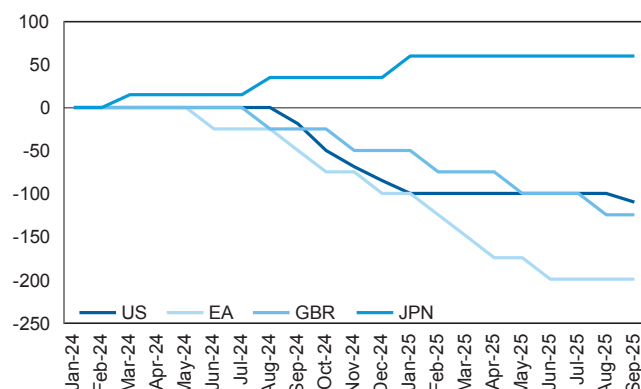
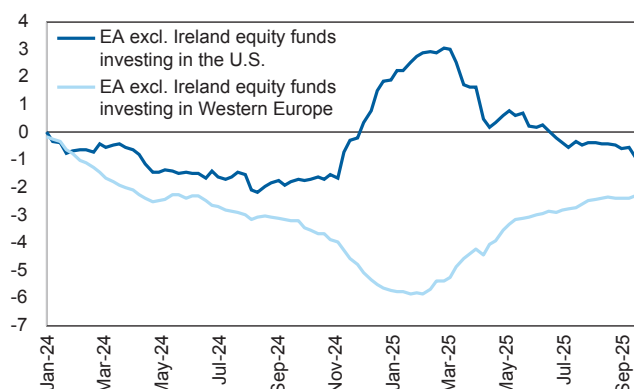
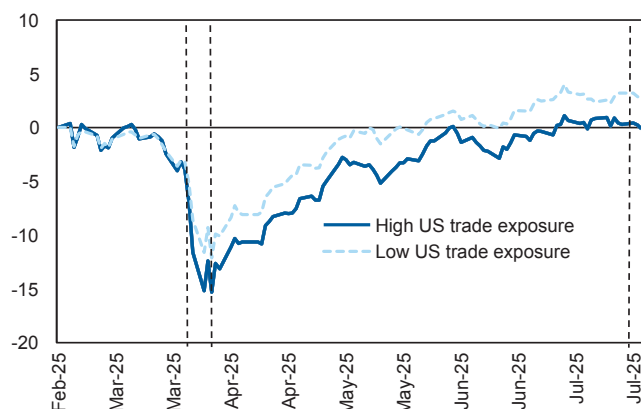
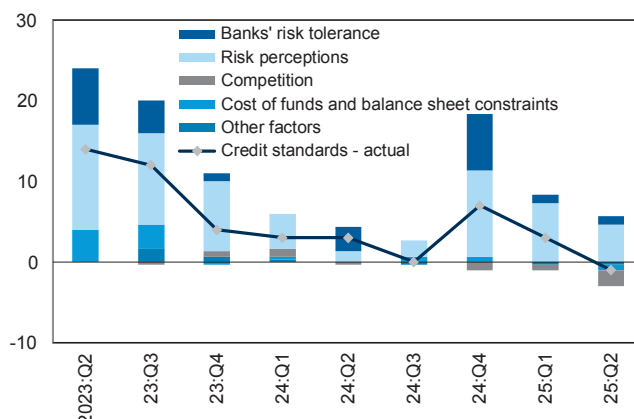
2. US Trade-Weighted Average Tariff Rate by Region

(Percent)



Sources: Baker, Bloom, and Davis (2016); Caldara and others (2020); and WTO-IMF Tariff Tracker.

Note: Panel 1 refers to metrics of uncertainty for Europe. However, these may also reflect uncertainty arising from global events. Values are shown as end-of-period observations. Panel 2 contains information as of September 15, 2025. The graph reports trade-weighted average tariffs, calculated as the weighted average of ad valorem rates or ad valorem equivalents (AVEs) of MFN applied and preferential tariffs, including tariff actions. Calculations are based on pre-aggregated HS six-digit averages. The tariffs shown correspond to effectively applied duties that are currently in force or have been in effect. "Pre-2025" refers to tariff levels in place before January 1, 2025.

Figure 3. Interest Rates, Exchange Rates, Fund Flows, and Stock Returns**1. 10-Year Government Bond Yields***(Basis point change since January 2024)***2. Nominal Effective Exchange Rate***(Index, January 1, 2025 = 100)***3. Monetary Policy Rates***(Basis point change since January 2024)***4. Cumulative Flows into Euro Area Equity Funds***(Percentage of beginning of period's total net assets)***5. Cumulative Stock Returns for European Firms***(Percent, March 25 = 0)***6. Changes in Credit Standards for Euro Area Enterprises and their Contributing Factors***(Net percentages balance)*

Sources: ECB (BLS); Bloomberg Finance L.P.; Haver Analytics; Beyer, Tong, and Zhou (2025); EPFR Global; and IMF staff calculations. Note: Panel 5 plots the average cumulative raw returns of European firms from February 28 to July 30, 2025. Firms with high versus low trade exposure, constructed following Claessens, Kose, and Terrones (2012), are classified relative to the sample median, with vertical dashed lines marking the three key US trade policy events: "Liberation Day" (April 2), "Pause Day" (April 9), and "Deal Day" (July 27). In panel 6, credit standards are defined as banks' internal guidelines or loan approval criteria impacting the overall supply of loans. Net percentages are defined as the difference between the sum of the percentages of banks responding "tightened" and the sum of the percentages of banks responding "eased". A positive net percentage balance indicates that a large proportion of banks have tightened credit standards. A negative number would refer to a net easing of credit standards.

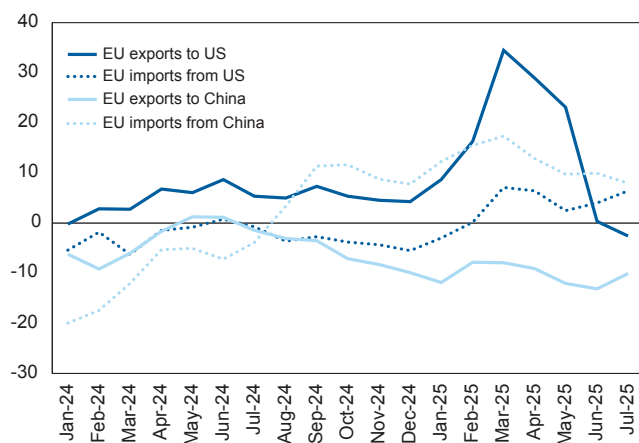
The growth slowdown goes beyond a softening of external demand and extends across most European countries.

- In Europe's advanced economies (AEs), the positive growth surprise in the first half of 2025 came from frontloaded exports to the United States and associated investment (Figure 4), especially in Ireland, excluding which growth was modest. As the temporary boost fades, growth has resumed to converge to its low long-term potential. Private consumption has remained stable at modest levels, supported by the catching up of real income growth because of declining prices but held back by uncertainty and still elevated saving rates (Figure 5). Recent IMF analysis finds that the increase in the savings rate comes mostly from cyclical factors, especially rising interest rates. More recently, sentiment factors (potentially capturing precautionary motives) might have also contributed (Figure 5).

Figure 4. Frontloading and GDP Growth

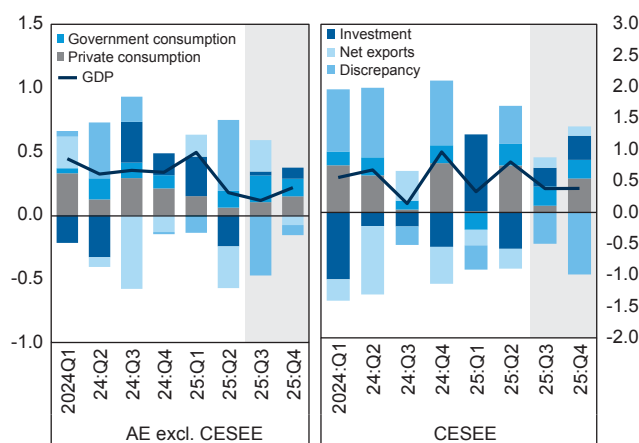
1. EU-China and EU-US Trade Flows

(Percent, year over year)



2. Growth Decomposition

(Percent change, quarter over quarter)



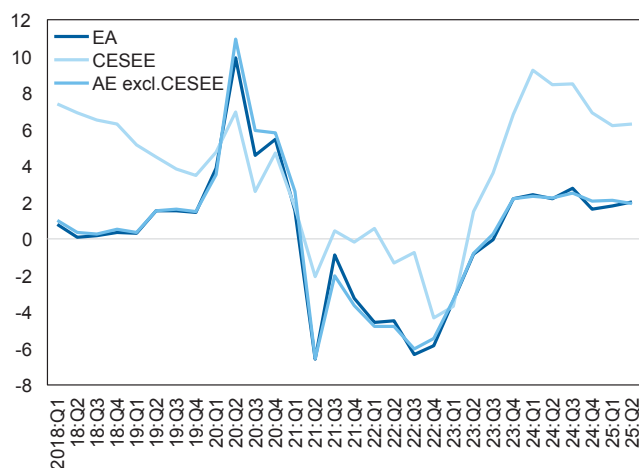
Sources: Haver analytics; IMF, World Economic Outlook database; and IMF calculations.

Note: In panel 1, the calculation is based on a three-month moving average. In panel 2, AE excl. CESEE excludes Iceland, Luxembourg, Malta, and San Marino. CESEE excludes Albania, Bosnia and Herzegovina, Bulgaria, Czech Republic, Kosovo, Latvia, North Macedonia, Moldova, Montenegro, and Serbia.

Figure 5. Real Income and Household Saving

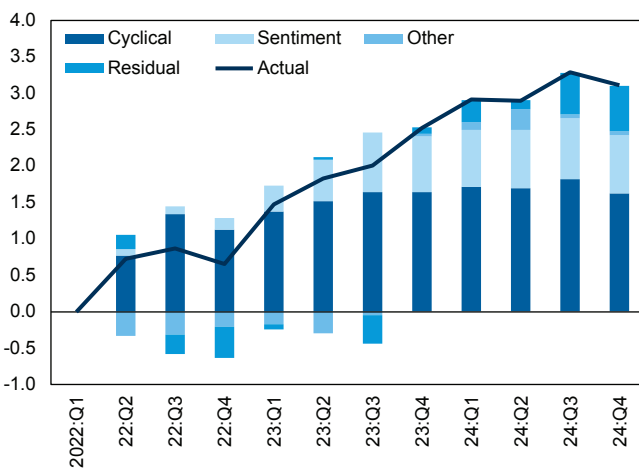
1. Real Income Growth

(Percent, year over year)



2. EU: Contribution to Change in Gross Savings Rate

(Percentage points)

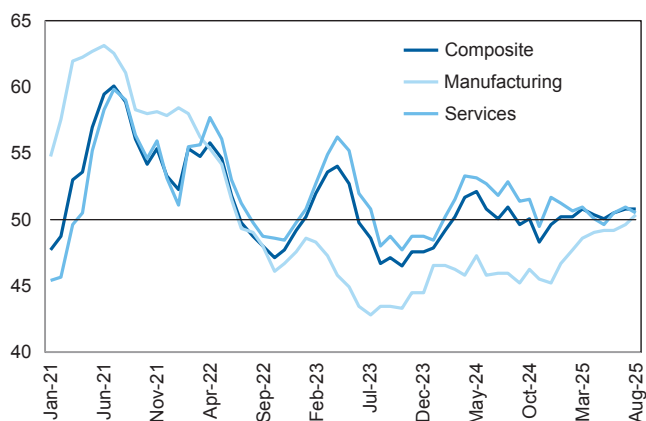


Sources: Eurostat; Haver Analytics; and IMF staff calculations.

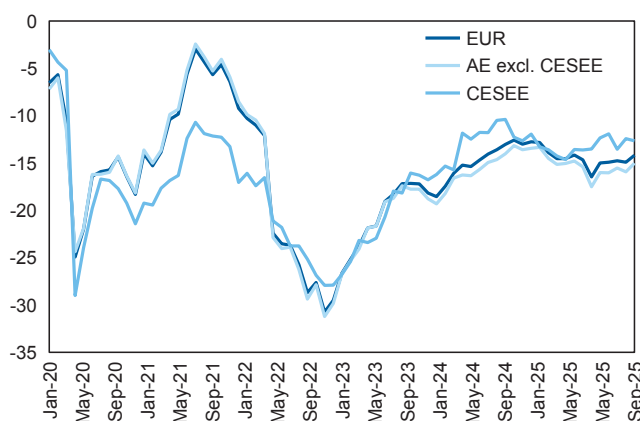
Note: In panel 1, real income is defined as compensation per employee adjusted for the consumer price index. CESEE excludes Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Moldova, Montenegro, and Serbia. AE excl. CESEE excludes Iceland, Israel, San Marino and Switzerland. In panel 2, the chart gives the (GDP-weighted) deviation in the household gross savings rate from its 2022Q2 level and the model-based drivers of this deviation. The model is a fixed-effect panel regression (over 2000Q1 to 2025Q1 with fixed effects and year dummies for the GFC 2009 and Covid 2020/2021) of the household gross savings rate on real household gross disposable income, the short-term interest rate, HICP inflation, the general government balance (as % of GDP), general economic sentiment (European Commission survey demeaned), the net financial wealth share (% of GDP), outstanding household loans (% of GDP), and the old-age dependency ratio. Countries include Austria, Belgium, Germany, Spain, Finland, France, Greece, Ireland, Italy, Netherlands and Portugal; Other is Czech Republic, Denmark, Sweden, UK, Hungary and Poland (determined by quarterly data availability).

Figure 6. Purchasing Managers' Index and Consumer Confidence**1. EU Purchasing Managers' Index**

(SA, 50 + = expansion)

**2. Consumer Confidence**

(SA, Percent balance)



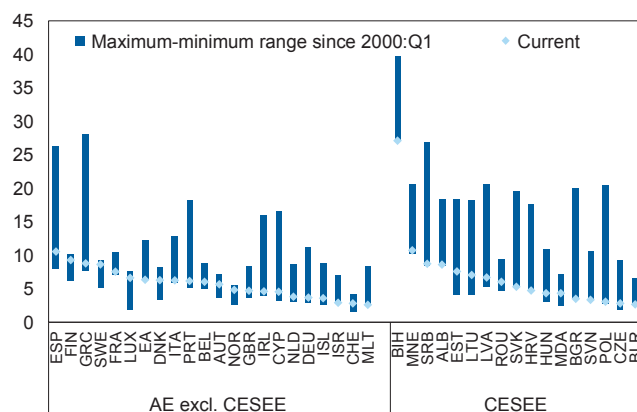
Sources: S&P Global; Haver Analytics; European Commission; and IMF staff calculations.

- Central, Eastern, and Southeastern Europe (CESEE) countries grew marginally lower than projected in the first quarter. The region is less reliant on the United States and hence less affected by export frontloading. Overall, domestic demand held up as real income growth remained solid—amid still high wage growth—supporting consumer confidence and consumption more than in AEs (Figure 6). Strong public investment in some countries boosted first-quarter growth, although net exports remained subdued. In Ukraine, attacks on production facilities and weak agricultural exports offset the positive impulse from the reconstruction of energy infrastructure and continued accommodative fiscal stance.

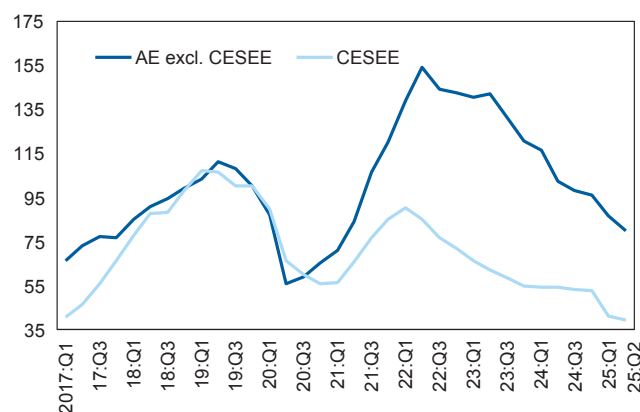
The labor market is cooling. Job creation in the first half of 2025 was modest in AEs and started to trend down in CESEE. Labor market tightness has continued to reverse, and the average vacancies-to-unemployment ratio has fallen below the pre-pandemic level (Figure 7). The European Central Bank's (ECB) latest wage tracker data continue to show easing pressures; however, employment expectations stay below long-term trend. Unemployment rates remain low in most European countries because of declining labor force, especially in CESEE.

Figure 7. Labor Market**1. Unemployment Rate, 2025:Q1 or Later**

(Percent)

**2. Vacancy-to-Unemployment Ratio**

(Index, 2019:Q4 = 100)



Sources: Haver Analytics; and IMF staff calculations.

Note: In panel 2, CESEE includes Belarus and Russia.

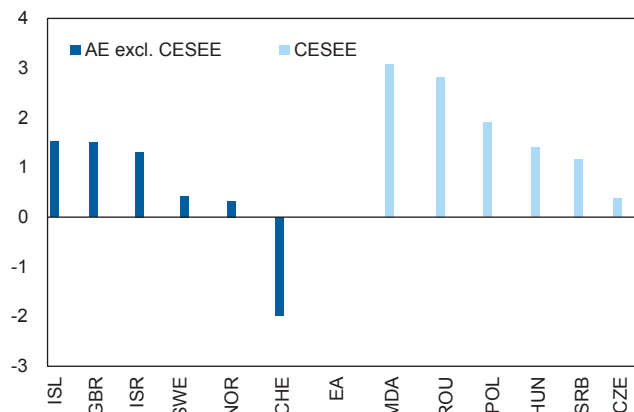
Inflation Is on Target in Advanced Economies but Eases Unevenly across Central, Eastern, and Southeastern Europe

Price pressures have receded in the euro area but remain mixed elsewhere in Europe. In the euro area, inflation has reached its target level. Weak energy inflation, broad-based deceleration in services inflation, and the appreciation of the euro since February all contributed. In the United Kingdom, headline inflation started to pick up in the second half of 2024 on the back of regulated price increases, the employer National Insurance Contributions rate hike, and waning base effects from energy prices, but the rise should be temporary. Disinflation in the CESEE region has been slower and uneven, with inflation in most countries still 1–3 percentage points above targets as of the second quarter of 2025 (Figure 8) and recently increasing again in a few countries (for example, Romania, Czech Republic, Serbia). In Switzerland, headline inflation slowed to 0.2 percent (year-over-year) in July 2025, reflecting the strong Swiss franc and lower energy prices. Although core inflation has been sticky in AEs, services inflation—still above the target and pre-COVID trend—has begun to moderate. Inflation persistence has been stronger in services for many CESEE countries (Croatia, Hungary, Romania), entrenching high unit-labor cost growth and eroding competitiveness (Figure 8). In Türkiye, the still-high domestic demand slows the disinflation while the gradual normalization of policies starts to improve the outlook.

Figure 8. Inflation

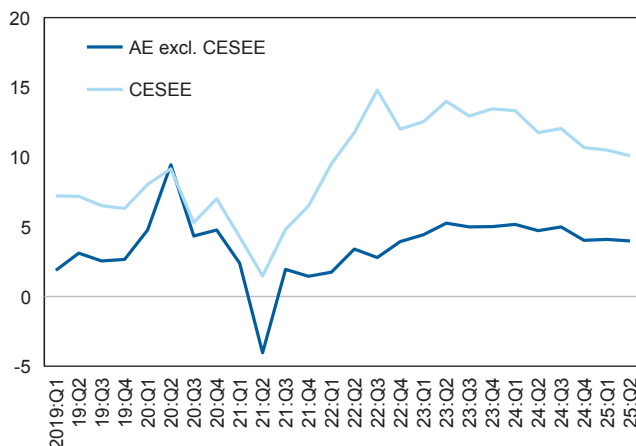
1. Inflation Deviation from Target

(Percentage points, as of 2025:Q2)



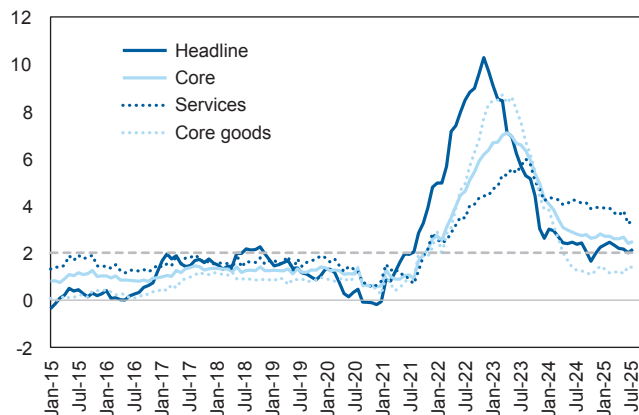
2. Nominal Wage Growth

(Percent points, year over year)



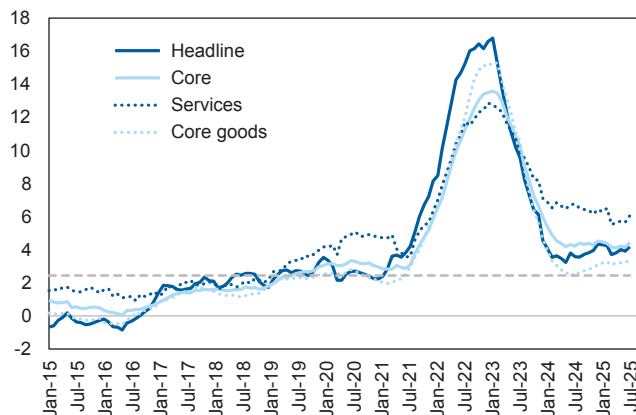
3. AE excl. CESEE: Headline and Core Inflation

(Year over year, quarterly)



4. CESEE: Headline and Core Inflation

(Year over year, quarterly)



Sources: IMF; World Economic Outlook database; Haver Analytics; Eurostat; Office of National Statistics; and IMF staff calculations.

Note: In panel 2, CESEE excludes Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Moldova, Montenegro, and Serbia. AE excl. CESEE excludes San Marino and Israel. In panels 3 and 4, core goods are defined as goods excluding unprocessed food and energy.

AE excl. CESEE excludes San Marino and Israel. CESEE excludes Albania, Bosnia and Herzegovina, Kosovo, Moldova and Montenegro, Russia, Serbia, Switzerland, and UK are not included in the country samples for core goods in July and August of 2025 due to data availability.

Outlook and Risks

Headwinds from Uncertainty, Trade Tensions, and Euro Appreciation

The baseline forecast implies modest growth in 2026 and beyond despite a slight uptick in 2025. The forecasts for 2025 for AE and CESEE countries remain broadly the same compared to the July WEO Update with tariff-related frontloading in the background. Yet underlying growth continues to be close to a slowing potential rate. In AEs, projected growth is 1.3 percent in 2026, 1.5 percent in 2027, and converging to about 1 percent thereafter, in line with July projections. The CESEE region will grow at a relatively higher pace at 2.5 percent in 2026, 2.7 percent in 2027 and beyond, unchanged from the July forecast. Overall, Europe lacks the much-needed reform momentum to lift its potential amid headwinds from demographics and public spending needs. Additional trade tensions or slower global growth pose significant risks, potentially affecting AEs and having stronger spillover effects on CESEE (Box 1). Russia's growth is expected to slow further to 0.6 and 1 percent in 2025 and 2026, respectively, due to cyclical factors and tight policies.

Multiple factors contribute to the lackluster growth outlook.

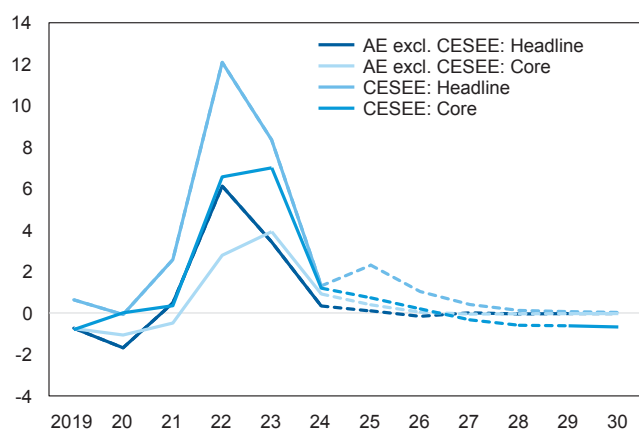
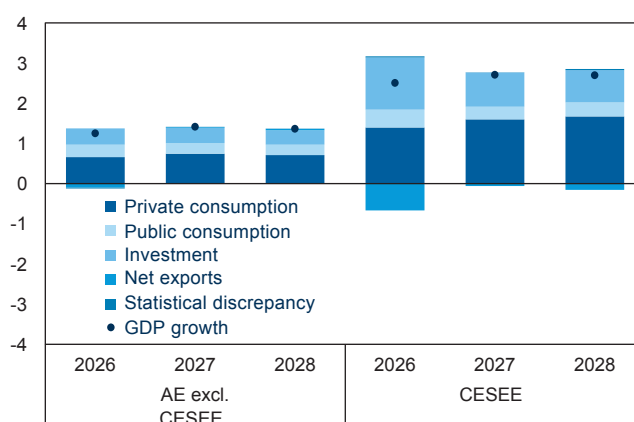
- **Uncertainty and trade policy will dampen euro area growth** by about 0.5 percentage points in 2026–27. Higher tariffs constitute a direct adverse demand shock for EU exporters. The uncertainty around trade policy remains very high and, together with the geopolitical risks in Europe, will continue to dampen sentiment and weigh on investment and associated job creation despite looser monetary policy. Uncertainty—which is expected to persist through 2026—also weighs on private consumption despite projected gains in real income. Beyond 2027, growth will gradually lower to about 1 percent, in line with potential.
- **Fiscal spending, including new defense and infrastructure spending offers a limited demand offset** of about 0.4 percentage points in 2026–27. NATO member EU governments announced plans to increase defense spending. The increase over the next five years is expected to be about 0.7 percent in the EU. In addition, an uptick in infrastructure investment mostly comes from Germany over a 12-year period, with its fiscal package, which will also boost euro area growth. Where defense spending results in a fiscal stimulus, it may contribute to economic growth; however, the near-term effects are expected to be modest because spending would be over an extended period of time, leak into imports, and, in countries with limited fiscal space, potentially delay growth-boosting investments.
- **Euro strengthening above the baseline would pose a downward risk** for exports and growth. Further appreciation could also reinforce a structural reallocation in global portfolios in favor of euro area assets and add to the euro's safe-haven status. While possibly easing financial conditions, this could further add upward pressure on the euro. Most CESEE currencies have moved in line with the euro except the Albanian lek which strongly appreciated.

Euro Area: GDP Growth Revisions

(October 2025 WEO vs January 2025 WEO)

	2025	2026	2027
Tariff/trade	–0.1	–0.2	
Frontloading	0.3	–0.1	
Uncertainty & financial conditions	–0.1	–0.2	–0.1
Fiscal spending	0.1	0.2	0.2
Overall impact	0.2	–0.3	0.1

Headline inflation in the euro area is projected to remain moderate, but convergence to targets in CESEE countries is slower (Figure 9). Headline inflation in the euro area is expected to average 1.9 percent in 2026 and 2.1 percent in 2027 and core inflation is expected at 2.1 percent in 2026 and 2 percent in 2027. Stronger euro and lower energy prices are among the reasons for inflation temporarily dropping below 2 percent. Overall, inflation risks are two-sided. Downward risks to goods inflation stem from a persistently stronger euro, further declines in energy prices, and trade diversion from China. Upward risks arise from possible countervailing duties against trade diversion or wage growth failing to moderate as quickly as anticipated. In the United Kingdom, inflation will converge to 2 percent by end-2026, whereas Switzerland's inflation is expected to rise slowly but remain low, reaching 0.6 percent in 2026 and 0.7 percent in 2027. In CESEE countries, disinflation will continue at a gradual pace with headline inflation of about 3.5 percent in 2026 and 2.9 in 2027. Most CESEE countries will likely meet their inflation targets only in the course of 2027.

Figure 9. Medium-Term Growth and Inflation Forecast**1. Inflation Forecast***(Percentage point, deviation from target)***2. Growth Forecast***(Percentage change, year over year)*

Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: In panel 1, CESEE excludes Albania, Bosnia and Herzegovina, Bulgaria, Kosovo, North Macedonia, and Montenegro.

Well-Known Barriers Are Holding Back Medium-Term Growth and Worsening the Fiscal Outlook

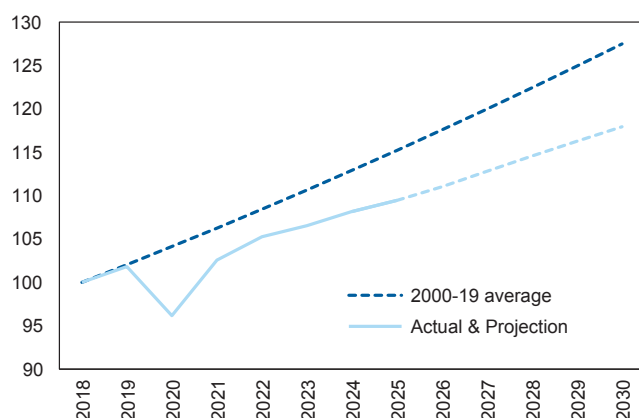
Europe's growth is expected to remain subdued over the medium term, primarily because of low productivity growth and weakening labor supply. Weak and declining productivity growth presents Europe's largest headwind to growth particularly in AEs (Figure 10). Europe's labor force is shrinking with population aging. And most CESEE countries suffer from a low capital stock because of still-depressed private investment rates. Previous studies linked low productivity to weak firm-level dynamics, which stem from large remaining intra-EU trade barriers, insufficiently integrated and deep capital markets to fund innovation, and barriers to incentivize labor to move to areas of growth opportunities (IMF 2024c; Draghi 2024; Letta 2024; Adilbish and others 2025). An upside risk to growth is a rise in productivity from the arrival of AI. Estimates for Europe are in the order of a 1 percent cumulative increase in the level of productivity (TFP) over five years (Misch et al 2025, IMF 2025c). The impact varies depending on countries' AI-readiness (e.g., skills and digital infrastructure) but also constrained by regional factors such as affordable electricity supply and funding for innovative investments.

While these structural deficiencies are well documented, analyses of how they play out "on the ground"—at the regional level—are still lacking. Growth barriers interact to suppress productivity in production hubs where firms cluster. Europe's large production hubs outperform less dense regions, as is the case in the United States, but with a more modest productivity advantage (Figure 11): for the same increase in employment density, European production hubs achieve about one-third less productivity gains than in the United States. New analysis (see October 2025 *Regional Economic Outlook: Europe* Note 2 "How to Better Leverage Europe's Hubs to Boost Productivity") links this underperformance to Europe's incomplete single market and domestic structural policy gaps. Productivity in Europe's production hubs would be higher if firms had access to larger, better integrated markets for their goods and services and if capital and labor were more mobile across regions. More integrated capital and energy markets would also raise the potential productivity benefits from AI which may otherwise limit dissemination of AI tools and innovation. And domestic reforms addressing structural gaps in areas such as labor market regulations, human capital, and regulatory burden would lift growth across all regions.

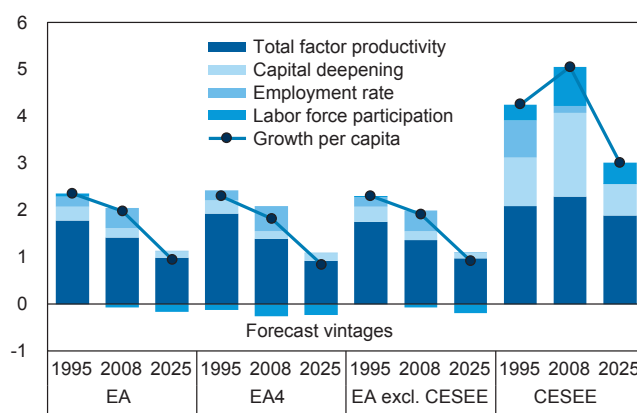
Most critical growth reforms are still at the deliberation stage. Europe has shown that it can move swiftly in the face of crises, but its persistent productivity gap to the global frontier and the resulting weakness of medium-term growth have yet to trigger a full and effective response. At the EU level, although the European Union's single market has come a long way, ongoing efforts to further deepen it—such as introducing a euro

Figure 10. Long-Term Growth Forecast**1. Real GDP in Europe**

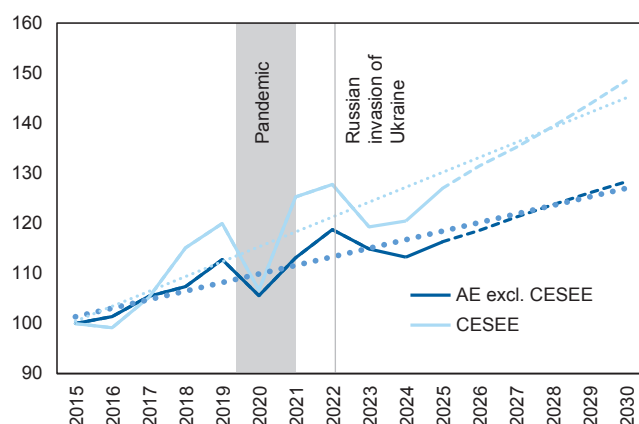
(Index, 2018 = 100)

**2. Five-Year-Ahead GDP per Capita Growth Forecast Decomposition**

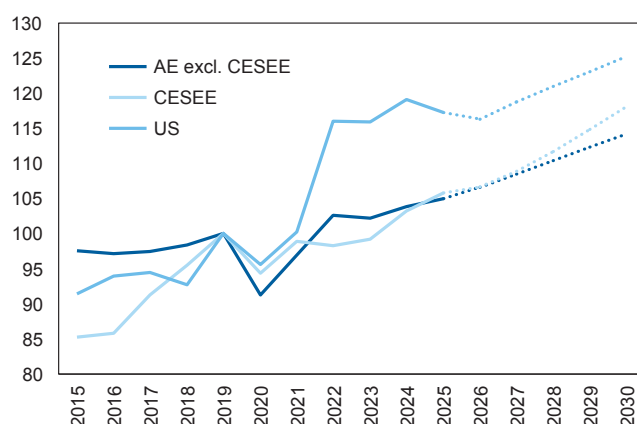
(Percent)

**3. Gross Real Capital Formation**

(Index, 2015=100)

**4. Real Private Consumption**

(Index, 2019 = 100)



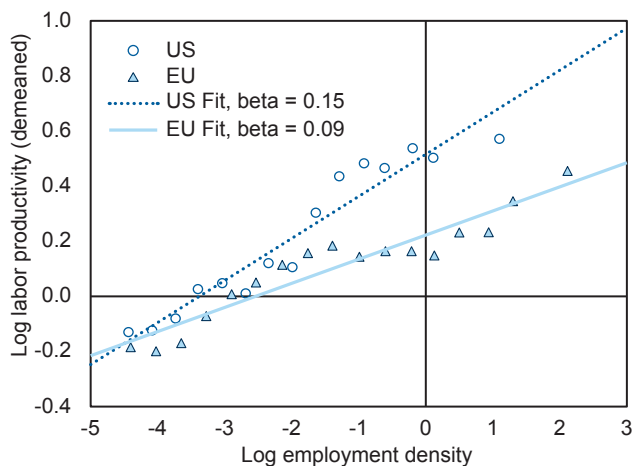
Sources: Penn World Table 10.01; IMF, World Economic Outlook database; and IMF staff calculations.

Note: In Panel 1 *Europe* includes: Albania, Austria, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Kosovo, Latvia, Lithuania, Luxembourg, North Macedonia, Malta, Moldova, Montenegro, the Netherlands, Norway, Poland, Portugal, Romania, Russia, San Marino, Serbia, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, and Andorra.

area-wide deposit insurance system, operationalizing the capital markets union, or completing the opening up of national service sectors—remain incomplete (Fabbrini 2019). New measures, such as the Competitiveness Compass, the introduction of a 28th regime for corporations, the start-up and scale-up strategy, and efforts to reduce barriers within the single market are in early stages. Drawn out discussion and watering down of proposals could lead to ineffective reforms. At the national level, well-known structural reform gaps remain unaddressed, even though there is no shortage of examples of successful past reforms (for example, Germany in the early 2000s, Nordic countries in the early 1990s, Southern Europe in the early 2010s) lifting productivity (Budina and others 2025).

Continued policy drift would not only weaken Europe's chances of raising medium-term growth but also greatly amplify the fiscal challenges ahead. Spending pressures—from rising pension and healthcare needs, as well as higher defense costs (Figure 12), along with energy security and climate spending—are expected to double over the next two decades, putting significant strain on Europe's public finances (Eble and others 2025). At the same time, fiscal space is very limited for many countries because of already high debt. Successful implementation of EU- and national-level reforms would alleviate some of the fiscal burden through higher growth, which

Figure 11. Elasticity of Labor Productivity to Density: European Union versus United States



Sources: Eurostat; American Community Survey; Bureau of Economic Analysis; and IMF staff calculations.

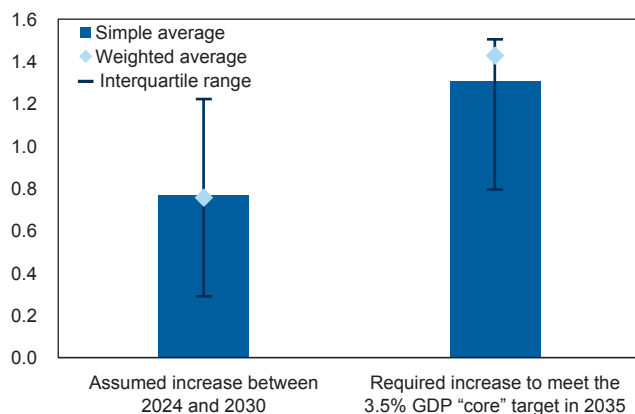
would improve debt dynamics and lower the need for difficult medium-term fiscal consolidation (October 2025 *Regional Economic Outlook: Europe* Note 1 "How to Pay for Things that Europe Cannot Afford").

Increasing sovereign yields underpin the importance of fiscal discipline. Current market interest rates appear to be more sensitive to fiscal news than in the late 2010s when ECB monetary policy was firmly locked at the effective lower bound and global and European debt levels were lower (Lane 2024; EuroFi 2025). This suggests that, especially, high-debt countries with high-risk premiums will see their interest rates and debt servicing costs fall if they reign in deficits and put their debt-to-GDP ratios on a sustainable path. Sustainably addressing fiscal pressures could also lower interest rates more generally, supporting private sector investment and GDP growth over the medium term.

Figure 12. Defense and Infrastructure Spending

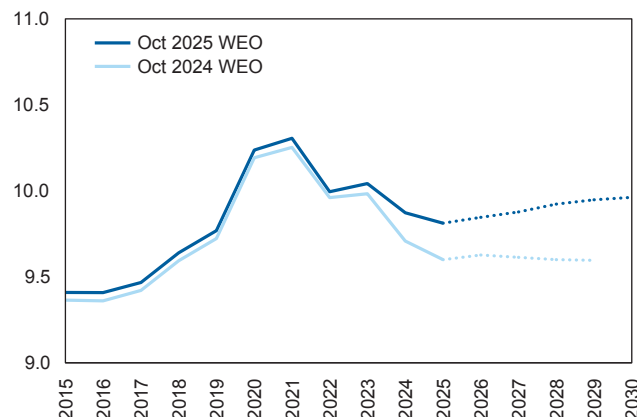
1. Core Defense Spending in European Union

(Percentage points of GDP compared to 2024 levels)



2. Infrastructure Spending in European Union

(Percent of GDP)

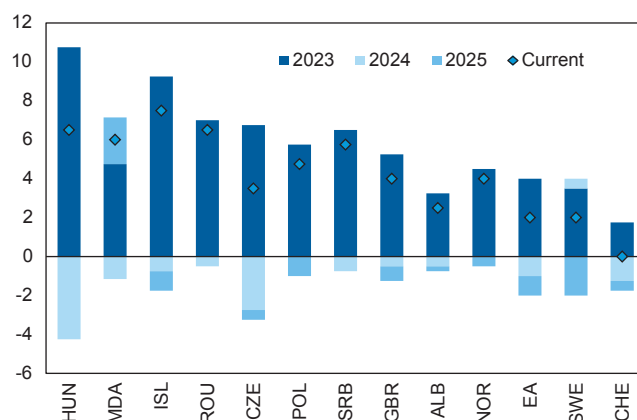
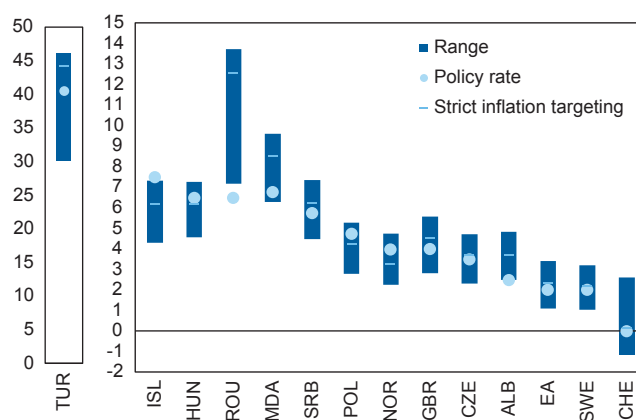


Sources: Eble and others (2025); NATO; IMF EUR fiscal desk survey (April 2025); IMF, World Economic Outlook; and IMF staff calculations.

Note: For panel 1, according to NATO accounting, core defense spending refers to government expenditures essential for the maintenance and operation of national armed forces, mainly those recorded in the Ministry of Defense budget. It covers personnel, operations, equipment procurement and maintenance, military pensions, research and development, peacekeeping, and contributions to NATO common infrastructure. Spending outside these core military functions, such as civil defense or war damage payments, is excluded. The whiskers span 50 percent of the data, from the bottom 25 percent to the upper 75 percent. For panel 2, EU country samples include Austria, Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Portugal, Slovenia, Spain, and Sweden.

Steady Macro Policies for Near-Term Stability

Steady macro policies will help firms and households navigate an uncertain environment while paving the way to robust long-term growth in a changed global environment. In the near term, this means maintaining or transitioning to a neutral monetary policy stance in countries with inflation on target, while initiating fiscal adjustment at a pace attuned to fiscal risks and the cyclical position.

Figure 13. Monetary Policy**1. Monetary Policy Rate Developments**
(Percent)**2. Current Policy Rate and Estimated Taylor Rule**
(Percent)

Sources: National Central Banks; Haver Analytics; Consensus Economics; IMF, World Economic Outlook database; and IMF staff calculations.

Note: In panel 1, 2025 covers first, second and third quarters only. 2023 is the end of period rate. 2024 shows the change from end-2023, and 2025 is the change from end-2024. For Hungary, the policy rate shows overnight interbank offer rate (BUBOR). Panel 2 compares the current nominal policy rate to an estimated range of rates consistent with a Taylor-type rule, allowing for uncertainty about the neutral rate of interest, and different central bank reaction functions (April 2023 *Regional Economic Outlook: Europe*). For illustrative purposes, the "Strict inflation targeting" lines indicate a Taylor rule rate for the hypothetical case where the central bank responds to inflation deviations from target, but not to changes in the output gap. This rule does not necessarily reflect the optimal simple policy rule or central bank mandates. Euro area policy rate refers to the deposit facility rate. Data labels in the figure use International Organization for Standardization (ISO) country codes. EA = euro area.

Monetary Policy: An Anchor by Remaining Focused on Price Stability

Monetary policy has continued to ease amid continuing disinflation, although real rates in many countries remain above their natural levels. The ECB has reduced its policy rate by a cumulative 200 bps since it started its easing cycle in the second quarter of 2024 as inflation started to decline more durably, moving to a neutral stance (Figure 13). Sustained disinflation and negative output gaps have led the Swiss central bank to progressively cut the interest rate to zero. In contrast, some countries (for example, Poland, Serbia, Iceland) have maintained a tighter policy stance with real rates above neutral rates. This reflects primarily inflation above the target, broadly consistent with the range implied by the Taylor rule.

With price stability within reach, policy decisions can become less guided by the latest data and more by forward-looking analysis. But central banks need to remain vigilant for unexpected changes in inflation or its drivers—such as wage growth, energy prices, inflation expectations, or monetary transmission—and adjust policy as needed:

- In AEs, policy rate calibration should provide sufficient flexibility in response to significant inflation developments. The current macroeconomic configuration in the euro area—headline inflation at target, core inflation slightly above, and a mildly negative output gap—supports the ECB maintaining a broadly neutral monetary stance. Rate changes would be warranted if incoming data pointed to a material shift in the inflation outlook—especially if there is a risk that expectations could become de-anchored. Recent IMF analysis offers guidance on the definition of a "material shift" (Dizioli 2025). For example, with inflation expectations well anchored, it would take a cost shock that reduces core inflation by 0.2 percentage points for four consecutive quarters to justify a 25 basis point policy rate adjustment. If a shock materially alters the expected trajectory of inflation, monetary policy should respond decisively because the welfare costs of underestimating inflation persistence outweigh those of overestimating. For the United Kingdom, the current gradual approach to further policy easing still strikes the right balance between supporting the economy and managing inflation risks. In Switzerland, with limited room for further easing, careful tool calibration and enhanced communication are essential to guide expectations.

- In CESEE, a prudent and data-driven approach remains essential. Where inflation remains stubbornly above the target, monetary policy must continue to account for the lingering asymmetry of risks, especially in economies where robust wage growth threatens to spill over into higher service prices (for example, Hungary, Poland, Romania). A premature loosening policy under such conditions risks de-anchoring inflation expectations, potentially necessitating even stricter measures in the future. Recent analysis shows that clear communication of economic assessment and policy action in pursuit of stated goals have been effective in limiting the negative effects of uncertainty and risk-off events on emerging market economies (IMF 2025f).

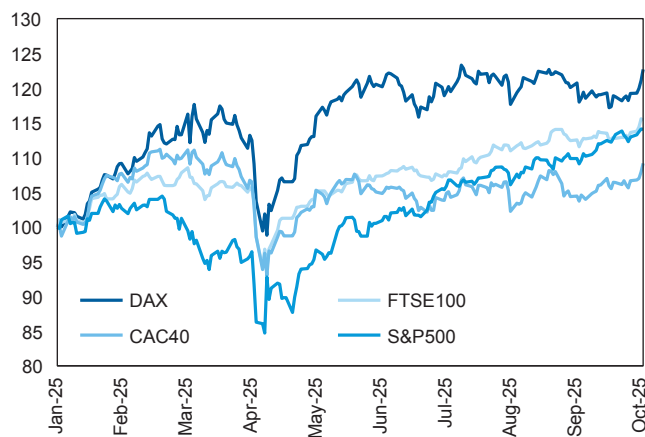
Financial Policy: Steering through Uncertainty

Banks are resilient, but elevated uncertainty and slower growth increase credit risks and reinforce the need for macro-prudential buffers. Capital and liquidity levels are generally strong, supported by steady—though slower—profit growth (Figure 14). Asset quality remains robust, with euro area banks' non-performing loans (NPLs) near record lows and credit quality continuing to improve in CESEE. The gradual recovery in real estate prices could mitigate the asset

Figure 14. Financial Policy

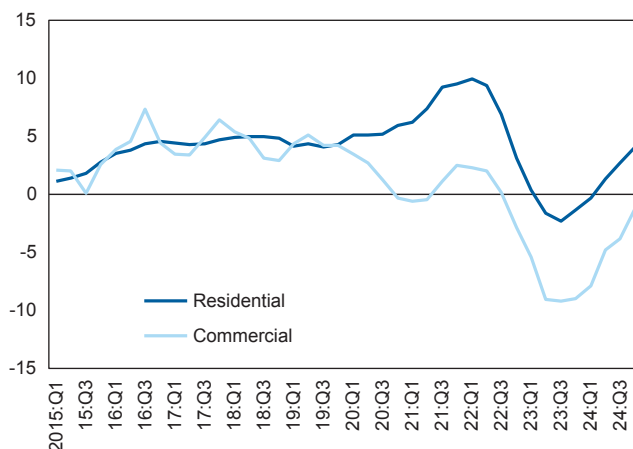
1. Stock Market Indices

(Market Index, January 1, 2025 = 100)



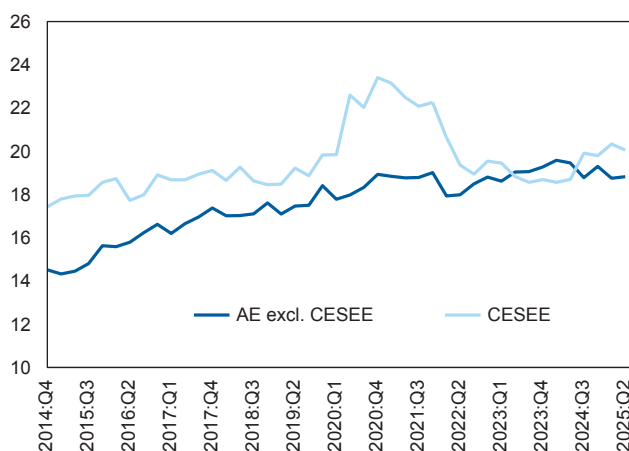
2. Euro Area: Real Estate Price Change

(Percent change, year over year)



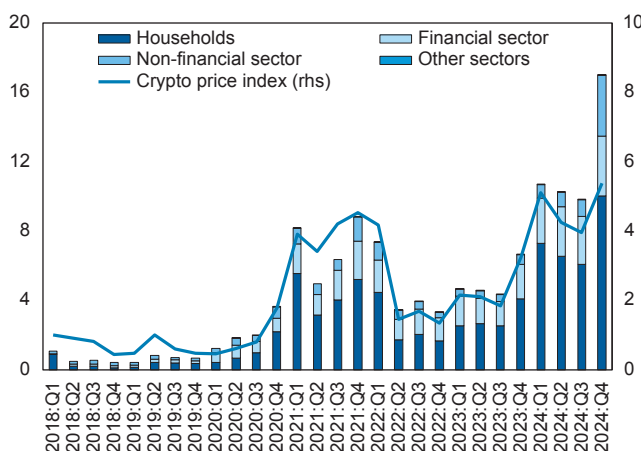
3. Bank Capital Buffer

(Percent)



4. Market Value of Euro Area Holdings of Crypto Asset-Related Investment Products

(LHS: Euro in billions, RHS: index: 2018:Q1 = 1)



Sources: EBA Risk Dashboard; Bloomberg Finance L.P.; European Central Bank; Haver Analytics; and IMF staff calculations.

Note: In panel 3, the values refer to the median of Tier 1 Capital Ratio. AE excl. CESEE excludes Iceland, Israel, San Marino, and Switzerland. CESEE excludes Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Moldova, Montenegro, and Serbia.

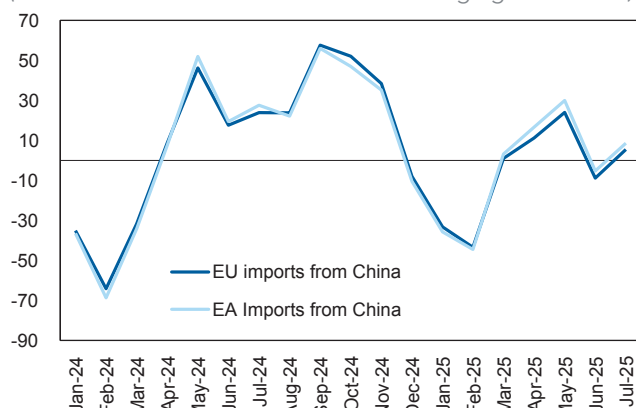
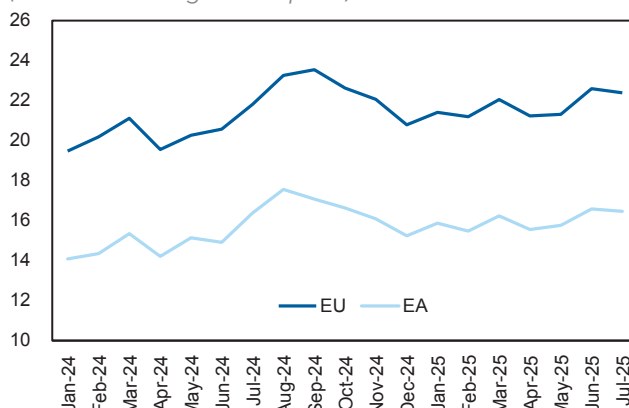
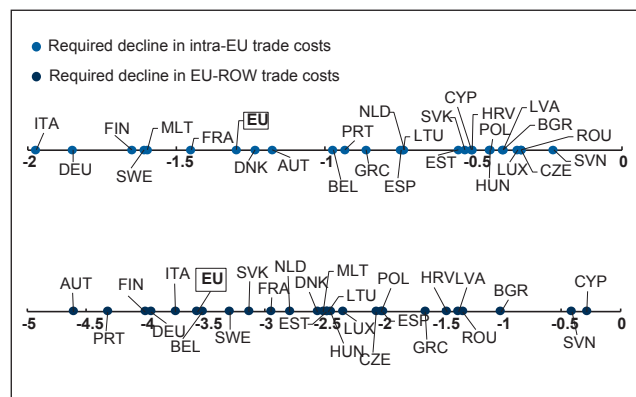
quality risk of some banks. However, rising trade tensions could negatively affect the corporate sector's profitability and insolvency, especially for highly export-oriented and tariff-sensitive sectors (for example, steel and automotive). The resulting deterioration in the corporate balance sheet would imply credit risks for banks, particularly for banks with higher exposure to sectors relying on extra-EU trade. Given the uncertain external environment, macroprudential capital buffers should remain sufficient to preserve banking sector resilience complemented with microprudential responses where necessary. Maintaining borrower-based measures is essential for sound lending standards throughout the financial cycle (European Central Bank 2025). Banks should implement prudent lending standards and risk management practice, including appropriate asset classification and adequate provisioning.

Liquidity and leverage vulnerabilities in the nonbank financial institution (NBFI) sector call for robust prudential policies and system-wide stress tests as well as more data. Nonbanking financial institutions have so far weathered adverse market turbulence relatively well, although they remain vulnerable to asset repricing and outflows induced by soaring market volatility. Increased interconnectedness of nonbanks, European banks' exposure to NBFI risks, and the vulnerabilities within the NBFI sector, including low liquidity and high leverage among certain participants, indicate a need for prudential measures (IMF 2025e). Countries should further develop NBFI-oriented prudential tools (for example, leverage limits and liquidity requirements) and accelerate plans for an EU system-wide stress test. Strengthening the resources and prudential powers of the supranational authorities with oversight of NBFIs is critical given the interlinkages between banks and nonbanks and their potential to amplify risks (IMF 2025e).

Crypto assets and stablecoins are more widely used and mainstreamed with looming risks for financial stability, requiring enhanced monitoring. The market capitalization of crypto assets has soared recently, fueled by positive investor interest and supportive policy stance in the United States. Recent legislative action in the United States on mainstreaming stablecoins and their fast growth not only offer new opportunities—by lowering transaction costs and enhancing financial inclusion—but also require close monitoring for emerging risks and adaptation by policymakers to internalize effects on policy transmission (Box 2). Significant use of stablecoins can have unintended consequences for monetary autonomy and monetary policy transmission. It could also pose risks to financial stability through interconnectedness with traditional finance, amplifying market volatility and lack of transparency. To reap the benefits of payment-related technological innovation and reduce potential dependence on decentralized private money, the EU is considering accelerating plans for the digital euro. The digital euro can offer benefits including reducing payment costs and promoting innovative payment solutions, deepening the EU single market, and preserving the role of central bank money as a payment anchor. Non-remunerated holdings and individual balance caps are under consideration to balance benefits and risks, although overly restrictive design choices could limit uptake, and adjustments to these features over time could enhance the benefits of the digital euro.

Trade Policy: Judicious Use of Safeguard Measures and Expanding Internal and External Trade

Several guiding principles can help shape an effective policy response to complex challenges arising from an evolving tariff landscape. Europe must remain committed to expanding trade by upholding its open trade policy and strengthening regional and global agreements, while also acknowledging that the rules of international trade are shifting. If significant trade diversion were to occur and viable sectors need time to adjust, policymakers should approach safeguards with caution, ensuring that they adhere to principles of the World Trade Organization, remain time limited, and are clearly communicated. Other support measures designed to mitigate the effects of tariffs should be temporary, targeted, and directed at clear market failures. Policymakers should establish clear, transparent, and time-consistent trade-policy road maps to reduce uncertainty and support investment (IMF 2025c). As of July 2025, there is limited evidence of trade diversion from China and other countries to the European Union despite the weakening of the Chinese renminbi alongside the US dollar. Import growth from China has not meaningfully accelerated in 2025, and the share of imports from China in total extra-EU and euro area imports has remained broadly stable (Figure 15). However, the EU trade surplus appears to weaken, and downside risks persist as gross data may understate the extent of trade diversion and long-term reallocation may be significant.

Figure 15. Trade Policy**1. Change in China's Exports to European Union***(Annualized 3-month-over-3-month average growth rates)***2. Share of Import Value from China***(Percent of total goods imports)***3. Partial-Equilibrium: Integration Needed to Offset Higher US Tariffs***(Ad-valorem percentage point reduction required)*

amount to only a fraction of the still significant intra-EU barriers to trade, as of 2020 estimated at an ad valorem equivalent cost of 44 percent on average for manufacturing sectors (IMF 2024).⁵

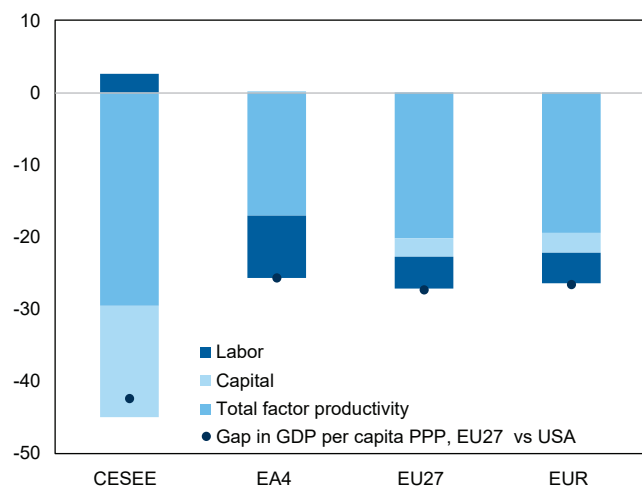
Reducing external trade barriers will require cooperation with other countries but would only require a slight decrease in the estimated remaining barriers to external goods trade, which are estimated at nearly twice the intra-EU level. This could also compensate for the lost US trade. For example, the EU forging deeper trade ties with other countries include ratifying the trade agreement with Mercosur, building deeper relationships with the United Kingdom and Switzerland, launching FTA negotiations with UAE and other GCC countries, and concluding the free trade agreement with ASEAN member countries. Of course, progress along both dimensions—further integration of the European Union's single market and intensifying global trade with global partners—would bring even larger rewards. And Europe should explore both options in full.

Achieving Higher Growth: Moving from Recognition to Action

A three-pillar strategy could help advancing national structural reforms and the EU single market delivering substantial output dividends for the EU—of at least 9 percent in 10 years (Box 3).

- At the national level, more efficient labor and capital allocation can help lift TFP, the main driver of Europe's substantive GDP per capita gap with the United States (Figure 16). This could be achieved through reforms in priority areas including labor, fiscal-structural, business regulation, innovation, and governance (Budina and others 2025). Better digital preparedness could also raise potential benefits from AI. Potential gains are larger for countries further away from the frontier, with the largest output gains from reform efforts aimed at closing 50 percent of the policy gaps—over 9 percent in the Western Balkans, followed by 7 percent in CESEE countries, and about 5 percent in AEs. In addition, there is scope for pension reforms in many countries (for example, to better align the retirement age with expected life spans).
- A more integrated EU single market can also bolster resilience, increase investment and spur innovation, boosting the EU GDP by at least 3 percent over the next 10 years. Addressing key binding constraints that hinder firms' ability to innovate and scale up within the EU single market could have significant outcomes on growth and productivity (Arnold and others 2025).⁶ Additionally, a unified energy market would enhance resilience, reduce energy costs and volatility, while accelerating decarbonization. To achieve this, the EU must establish a comprehensive, data-driven blueprint that aligns national and EU-level policies, closes information gaps,

Figure 16. Decomposition of GDP per Capita Difference with the United States
(in PPP terms, 2024)



Sources: AMECO; IMF, World Economic Outlook database; and staff calculations.

Note: For France, the 2023 capital stock value was used for 2024 and 2025 because of data unavailability. CESEE includes Bulgaria, Czechia, Estonia, Croatia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia, and Slovakia. EA4 = France, Germany, Italy, Spain; EU27 = European Union member countries; PPP = Purchasing Power Parity.

⁵ Box 2 in October 2025 *Regional Economic Outlook: Europe* Note 2 "How to Better Leverage Europe's Hubs to Boost Productivity" of this report shows further that these internal barriers have remained roughly constant between 2007 and 2022 and are significantly higher than barriers to trade between U.S. states. Specifically, the Box follows an approach that allows a direct comparison with the U.S. using aggregated (rather than sectoral, as in IMF (2024c)) manufactured and mining goods trade data. The analysis finds intra-EU barriers hovering around 40 percent between 2007 and 2022 for aggregate manufacturing goods, in contrast to intra-U.S. barriers that range between 21 and 26 percent.

⁶ The estimated level impact of around 9 percent 10 years out is derived by compounding the estimated impact of national reforms in EU countries (of 5.7 percent; see *National-Level Structural Priorities to Lift Growth in Europe: Why, What, and How?*), which bear fruit five years out, and the gains from single market reforms identified in Arnold and others (2025), which bear fruit over a 10-year period. These gains should be considered a lower bound given scope for further single market deepening, and because a concerted EU and national-level push would likely amplify their effects.

and identifies where joint action can deliver the greatest cost savings and impact. However, these measures require better coordination and buy-in at the implementation stage from both national and EU bodies. Reforms of the EU Multiannual Financial Framework (MFF), could help (Busse and others 2025): the EU should expand the provision of EU-level public goods (EPG), streamline the budget to enhance flexibility and performance-based budgeting, and integrate common debt as a regular financing tool (Box 3). This approach would enable strategically coordinating reform efforts and invest in public goods to maximize their impact.

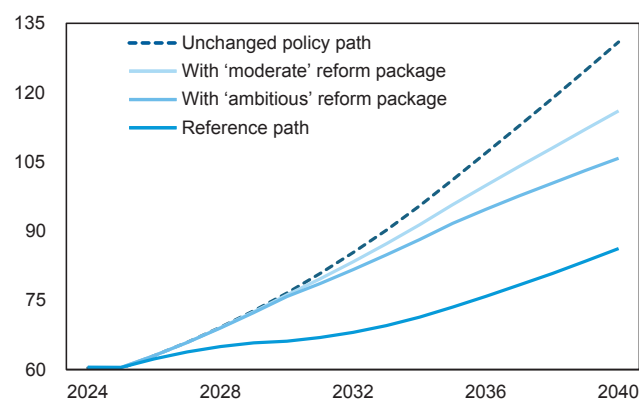
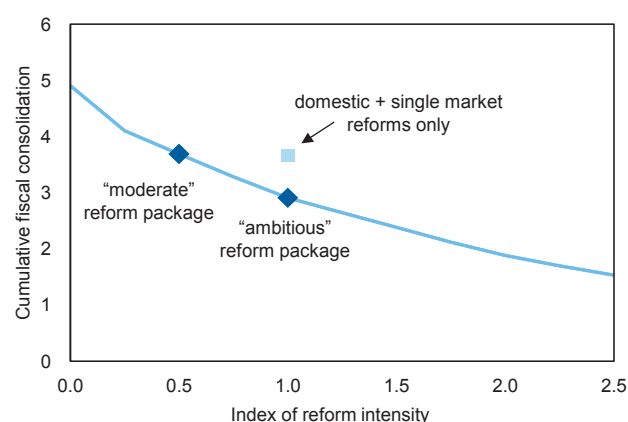
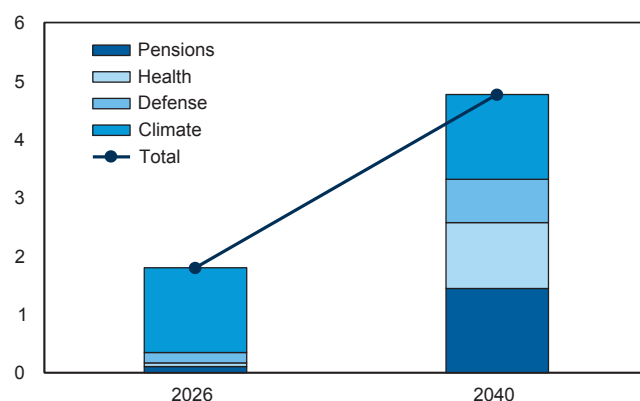
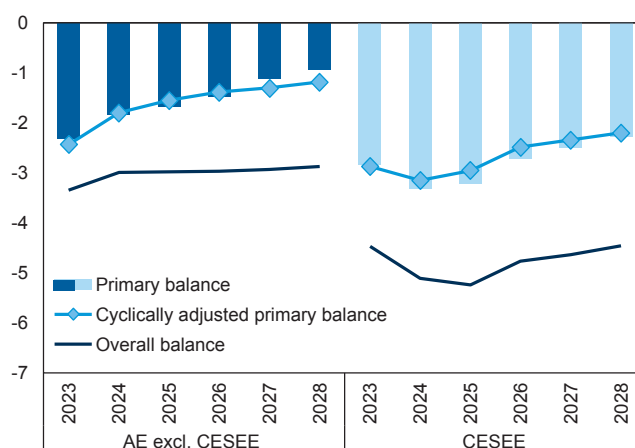
- Synergies and complementarities between national- and EU-level reforms would allow for higher and longer-lasting growth gains, lifting GDP per capita across most regions. Europe's larger economic hubs would see the largest gains, as they are originally more open and gain the most from exploiting economies of scale. But even less dense areas would on average gain in GDP-per-capita terms, from greater access to cheaper and more varied goods. However, a few regions lose out, as workers move to new opportunities. The losses call for targeted transfers to lagging regions to ensure that sizable overall gains are widely shared, designed to ensure that resources continue to go where they are most productive.

Securing Long-Term Fiscal Sustainability: Reforms and Adjustment

At current growth rates, existing fiscal plans are insufficient to manage Europe's enormous fiscal pressures. In AEs, with an increase in defense spending by NATO member countries and infrastructure spending by Germany, the consolidation pace has slowed down with the cyclically adjusted primary balance (CAPB) expected to improve only marginally by 0.2 percentage point this year. In CESEE, the overall CAPB is projected to improve by 0.4 percentage points in 2025 after a deterioration in 2024, but fiscal consolidation is proceeding more slowly in some countries (for example, Poland). At the same time, longer-term spending pressures from pension, health, and clean energy needs are expected to rise. But fiscal space is limited for many countries that already have high debt. Elevated public debt, an increasingly difficult financing environment, and new spending pressures are creating a fundamental sustainability challenge at a time when countries face political polarization, dissatisfaction with cost of living, and reform fatigue. Lack of consolidation implies a likely negative drag on growth in the medium-term, due to crowding out of priority spending and heightened rollover and interest rate risks (IMF 2025c).

- **Without a bold policy response, spending pressures would place debt on an explosive path.** Over a 15-year horizon, and with no growth reforms, no fiscal consolidation, and no change in public programs, debt for the average European country would reach 130 percent of GDP by 2040 (Figure 17)—or 155 percent of GDP on a GDP-weighted average basis, as some of the highest debt ratios are carried by Europe's larger economies. This is roughly a doubling from today's level, which would endanger debt sustainability. The debt surge could be even steeper if risk premiums were to rise and increase interest rates.
- **Addressing Europe's fiscal needs requires a comprehensive policy package combining growth-boosting reforms, medium-term consolidation, and—depending on circumstances—substantive fiscal reforms possibly involving difficult trade-offs.** The fiscal adjustment required depends on the structural reform effort put in to lift growth. As discussed in more detail in October 2025 *Regional Economic Outlook: Europe* Note 1 "How to Pay for Things that Europe Cannot Afford", an "ambitious" reform package that consists of national and EU level reforms outlined in the previous section (also in Box 3) and additional fiscal structural reforms would reduce the average country's debt-to-GDP ratio by 25 percentage points by 2040, relative to the unchanged policy path (Figure 17).⁷ As a result the debt trajectory would move about half of the way from the explosive unchanged policy debt path towards a sustainable reference debt path. Under a less ambitious "moderate" reform package that implements only about half of these reforms, the debt-to-GDP ratio would only decline by 15 percentage points of GDP bringing the average European country's debt one-third of the way towards the

⁷ Because many European countries have spending heavily tilted toward welfare expenditures, reorienting spending toward more productive uses would support growth while mitigating adjustment costs (See also IMF 2025d)

Figure 17. Fiscal Policy**1. Public Debt Under Different Reform Scenarios***(Percent of GDP; simple average of EUR countries)***2. Sustainable Combinations of Reform and Consolidation***(Percent of GDP, simple average of EUR countries)***3. Spending Pressures***(Percent of GDP; simple average of EUR countries)***4. Fiscal Balance***(Percent of GDP)*

Sources: October 2025 *Regional Economic Outlook: Europe* Note 2 "How to Better Leverage Europe's Hubs to Boost Productivity"; IMF, World Economic Outlook database; and IMF staff calculations.

Note: In panel 1, 2 and 3, EUR countries include Austria, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, North Macedonia, Poland, Portugal, Romania, Russia, Serbia, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Türkiye, and the United Kingdom. In panel 1, the reference path is based on a long-term debt anchor of 90 percent of GDP, so that for the average European country debt would remain below 90 percent of GDP from now until 2040. This would not mean that every country follows the same path. The "ambitious" package reflects the impact of adopting a set of reforms over the next five years, including domestic growth-enhancing measures, deeper integration of the single market, greater centralization of EU public goods, policies to catalyze private investment, and pension reforms. The "moderate" package includes reforms that are half as ambitious. In panel 2, fiscal consolidation is measured on a cumulative basis over 2026–30. The isoquant is computed using the constant sample of countries that need to adjust under the "moderate" reform package. No multiplier is assumed. Along the horizontal axis, more "intense" reforms have a progressively larger impact on growth and spending pressures. Index = 1 for "ambitious" reforms. In panel 3, additional spending pressures are calculated relative to 2025.

reference debt trajectory (Figure 17). Under both reform packages, the remainder of the gap to the reference path⁸ will have to be covered by fiscal consolidation, with the intensity of the needed efforts also depending on countries' starting debt levels and other circumstances.

⁸ The reference path indicates the development of the debt ratio for the average European country. For high-debt countries, the reference path ensures that debt stabilizes by 2030 and is put on a downward path during the next 10 years. For low-debt countries with significant spending pressures, the reference debt path would drift towards 90 percent of GDP in the long term.

- **Under the “moderate” reform package, there is a need for fiscal consolidation in about three-quarters of European countries to achieve the sustainable debt path.** The average European country would require an improvement in the cyclically adjusted primary balance (CAPB) of slightly above 3½ percent of GDP over the next five years. The adjustment needs are generally lower for countries with lower current debt levels. Under the “ambitious” reform package, fiscal adjustment needs for the average country could drop to slightly below 3 percent of GDP over the same horizon.
- **For countries with already high levels of debt, moderate growth and fiscal structural reform efforts and traditional fiscal consolidation measures likely will not be enough.** For around one quarter of European countries, consolidation of above 5 percent over five years would be required to achieve the sustainable debt path. This figure is significantly greater than the cumulative 3 to 4 percentage point improvement in CAPB achieved during previous periods of fiscal adjustment in Europe. This means that tougher decisions are required to either ramp up growth-lifting reforms or align public spending with available resources. For some countries, mostly AEs, this could mean a discussion about the social contract, involving difficult trade-offs between different spending priorities or reducing the level of some publicly provided services, while protecting the vulnerable by ensuring that lower-income households continue to access services at affordable rates at the point of use. Other countries, especially in the CESEE region, might have room to raise tax rates from relatively low levels, adjusting public revenue flows to the growing size of the public sector.

Overcoming Policy Drift

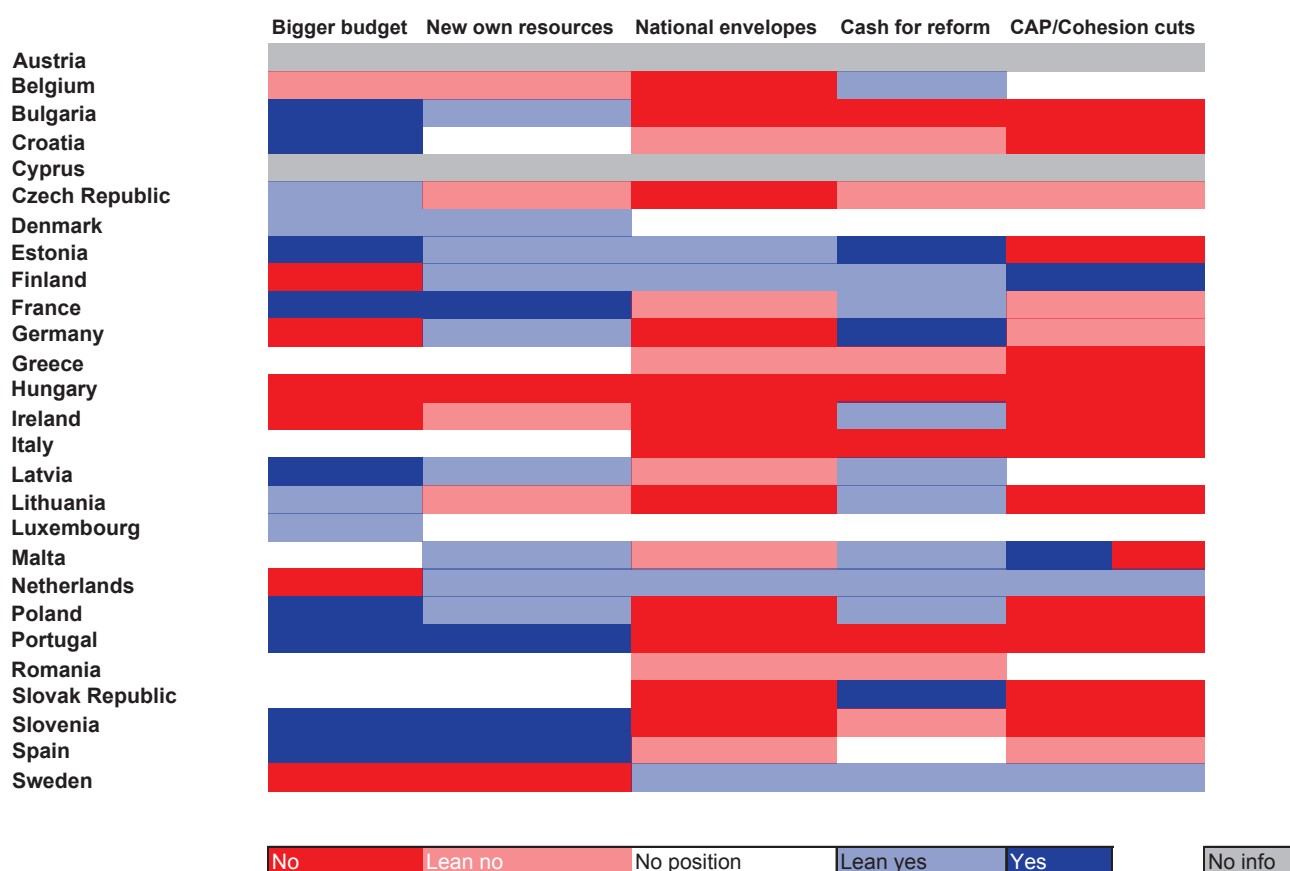
Reforms are difficult, but delayed or incomplete reforms are costly. Past successes hold important lessons on how to avoid a perilous policy drift. Major fiscal consolidation and reform efforts have often come during times of costly national or European crises. Ideally, structural reforms are implemented during periods of economic calm. The dilemma is that absent acute crisis pressures, the perceived costs of reforms tend to be more politically pressing than their future benefits. This empowers resistance from vested interests and can slow reform momentum. Yet, delaying reforms only heightens the adjustment cost: for instance, if reforms are implemented with five years delay the fiscal adjustment need increases by 1½ percentage points, under the “moderate” reform package discussed above, from just above 3 ½ to over 5 percent of GDP (October 2025 *Regional Economic Outlook: Europe* Note 1 “How to Pay for Things that Europe Cannot Afford”). Based on past experience, several strategies can make success more likely (IMF 2024b; Kammer 2025a):

- **Communication and institutional trust.** Effective communication and strong institutional frameworks are crucial for successful reforms, fostering trust and dialogue from the outset. Early outreach and clear articulation of objectives, as seen in the Netherlands (the disability insurance reform in 2002–06) and Poland (1999 pension reform), help build consensus and correct misinformation (Tompson and Dang 2010). Strategic framing can improve public support (IMF 2025a); however, capacity development and robust monitoring are essential in non-EU CESEE countries for overcoming challenges and sustaining progress.
- **Social dialogue and independent institutions.** Platforms for social dialogue are key in reform acceptance and implementation. Germany’s Hartz reforms and Dutch labor market changes benefited from active engagement with unions and employers (Tompson and Dang 2010; Banerjee and others 2017; Adhikari and others 2018). Denmark’s tripartite negotiations supported its “flexicurity” system (IMF 2024a). Mechanisms such as surveys and participatory budgeting further build stakeholder support (IMF 2024b). Independent bodies such as the Netherlands Bureau for Economic Policy Analysis (CPB) offer objective assessments that foster trust and reduce political resistance (Tompson and Dang 2010; IMF 2024b).
- **Bundling, sequencing, and timing of reforms.** The analysis of regional effects—at the production hub level—shows clearly that the bundling reforms help spread gains from reforms more evenly across regions. Careful bundling and sequencing of reforms can amplify their impact and ease adoption. Packages that provide net gains to a wide range of stakeholders (for example, Germany’s Hartz reforms, which paired benefit cuts with active labor market policies) can reduce resistance (IMF 2025a). Where reforms have heterogenous

effects at the regional level but are providing significant aggregate gains, well-designed policies, including the use of national and EU budgets, can help ensure that reform gains are widely shared. This is relevant, for example, when reforms to further enhance benefits from agglomeration accrue primarily at productivity hubs (October 2025 *Regional Economic Outlook: Europe* Note 2 “How to Better Leverage Europe’s Hubs to Boost Productivity”). Governance reforms that first build trust (for example, as in Estonia and Latvia (IMF 2019)) increase the benefits of later measures. By contrast, combining major pension and labor reforms may overwhelm workers, so careful sequencing is preferable (Tompson and Dang 2010). Although crises prompt action, implementing reforms during strong economic periods—such as Germany’s retirement age increase initiated in 2012—can improve public support and sustainability (Duval, Hong, and Timmer 2020).

More agile EU processes would support reform efforts. EU membership has been growing and so has the diversity of views (Figure 18) and the time and effort required to reach consensus. Consideration could be given to adapt the European Union’s policymaking hierarchy and to shorten decision-making processes in support of the structural reform agenda. This could, for example, involve moving toward majority voting rather than broad-based unanimity, or allowing carve-outs for progress among the willing under unanimity. An option to reduce regulatory fragmentation would be the introduction of fully harmonized EU-level legislation from the outset,

Figure 18. Impossible Unanimity: Diverging Views on the EU Budget



Source: IMF staff compilation based on information from the perception based on Euroactiv survey “Money talks: what the EU27 want from the next budget” (<https://www.euractiv.com/section/economy-jobs/news/what-the-eu-27-wants-from-the-next-budget/>).

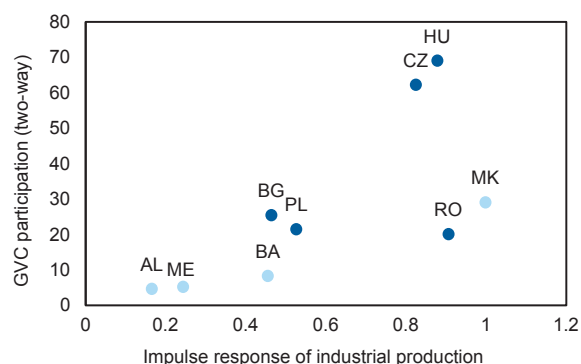
Note: Euroactiv surveyed all 27 EU governments and reviewed official position papers to gather views on five key budgetary questions: Size: Should the EU budget be increased?; Own resources: Should new EU-level revenue sources (for example, carbon tax, joint debt) be introduced?; National envelopes: Should funds for common agricultural policy (CAP) and cohesion be merged into national allocations?; Reform for cash: Should access to EU funds be conditional on implementing EU-aligned reforms?; CAP/Cohesion cuts: Should CAP and cohesion funding be reduced? This survey reflects expert interpretations and may be subject to bias. It does not represent the IMF’s assessment of member countries’ positions on EU budget issues. Methodological details and limitations should be considered when interpreting the results. Data labels in the figure use International Organization for Standardization (ISO) country codes.

prioritizing regulations over directives whenever possible (Arnold and others 2025). Regulations, being directly applicable, foster uniformity and mitigate sources of fragmentation; however, enforcement of directives should be strengthened to prevent gold-plating and ensure consistent implementation.

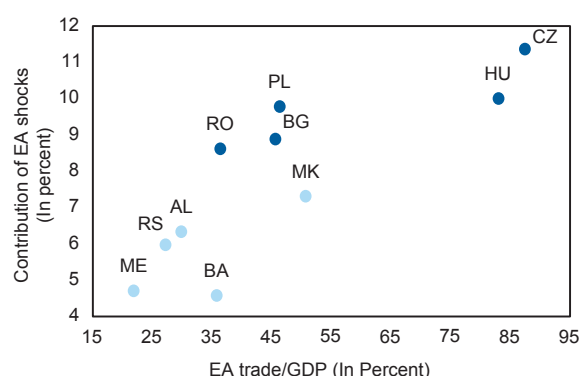
Europe stands at a pivotal juncture where navigating the immediate challenges of slow growth and external uncertainties must be complemented with bold, comprehensive reforms that unlock medium-term prosperity. Although many of the hurdles to Europe's success are beyond the region's immediate control, the solutions to overcome this lie firmly within its grasp. Achieving sustainable growth will require not only maintaining macro-economic stability and fiscal discipline but also decisively addressing deep-rooted structural barriers. These include enhancing productivity, fostering innovation, comprehensively addressing reform needs, deepening economic integration inside the European Union's single market, and, where needed, adjusting social contracts to ensure inclusiveness and fairness. By prioritizing innovation, championing further integration while preserving social cohesion, Europe can lift growth, fortify itself against external shocks, and preserve its existing welfare model. Overcoming policy drift will require strong political commitment, a social dialogue that brings along all stakeholders, and agile policymaking that responds to legitimate concerns. By pursuing these strategies, Europe can build a dynamic, competitive, and equitable economic future that benefits all citizens.

Box 1. CESEE in a Turbulent World: Spillovers from EU and Global Shocks¹

Box Figure 1.1. Spillovers to Industrial Production versus GVC Participation



Box Figure 1.2. Contribution of EA Shocks to CESEE Industrial Production



Sources: Haver Analytics; Eurostat; UNCTAD-Eora database; and IMF staff calculations.

Note: Ukraine is not covered because of data unavailability. For panel 1, peak impulse responses to a 1pc EA supply-side shock. Data labels in the figure use International Organization for Standardization (ISO) country codes. CESEE = Central, Eastern, and Southeastern Europe; EA = euro area; GVC = Global value chain.

CESEE countries have become progressively more integrated in Europe's single market intensifying their exposure to developments globally and in the euro area. With supply and commodity price shocks an ever-present possibility in a turbulent world, model simulations can shed light on the potential for substantial spillovers to CESEE growth and inflation.

The analysis finds that supply-side shocks in the euro area transmit substantively to CESEE output via production structures. Countries deeply embedded in European manufacturing networks (e.g. the automotive sector)—such as the Czech Republic, Hungary, Romania, and North Macedonia—tend to closely follow industrial output fluctuations in the euro area (Box Figure 1.1). The effects of such shocks can last up to a year as they move through the value chains via forward and backward linkages.

Trade linkages are the key channel. A decomposition of factors driving the variation in industrial production finds that euro area shocks transmit more strongly to CESEE countries with stronger trade integration with the euro area. The effects are more pronounced in CESEE EU member states, where euro area shocks account for approximately 7.5–11.5 percent of the variance in industrial production over two years, compared to less than 7.5 percent in the Western Balkans (Box Figure 1.2). Conversely, the less open economies in the Western Balkans are predominantly affected by domestic shocks, which contribute over 30 percent to the long-term variance in their economic activity (versus 10–20 percent in CESEE EU countries).

Global commodity prices are a key driver of inflation in CESEE. Price shocks contribute up to 35 percent to inflation variability after one year (Box Figure 1.3). Energy price shocks have a more pronounced impact in CESEE countries with high reliance on imported energy, elevated energy intensity, and limited energy source diversification. Similarly, food price shocks account for up to 20 percent of inflation variability in some countries, driven by the substantial weight of food in the CPI baskets across the region.

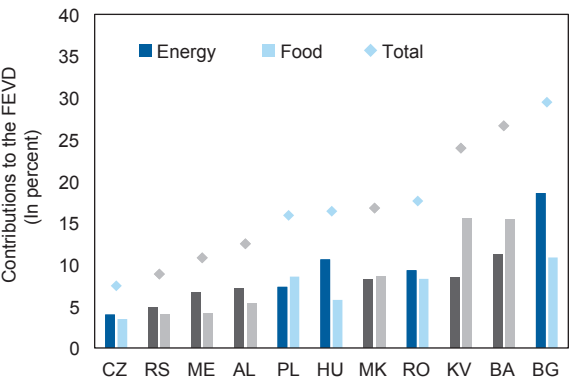
These results, in line with previous IMF advice (IMF 2024c; Kammer 2025b), underscore that safeguarding convergence will require policies to strengthen resilience to external shocks, deepen the benefits of

¹ Prepared by Annette Kyobe, Ming Ma and Adina Popescu.

Box 1. (continued)

integration, and ensure that CESEE countries can sustain robust and inclusive growth despite a turbulent global environment—with EU accession offering a pathway to accelerate growth, where short-term volatility is outweighed by substantial long-term income gains.

Box Figure 1.3. Contribution of Commodity Price Shocks to Inflation after One Year



Sources: Haver Analytics; and IMF staff calculations.
Note: Ukraine is not covered because of data unavailability. Data labels in the figure use International Organization for Standardization (ISO) country codes. FEVD = forecast error variance decompositions.

Box 2. Stablecoins—Macro Financial Stability Implications for Europe¹

Greater regulatory clarity and a more open US policy stance have boosted interest in stablecoins although market capitalization is still small.² The implementation of Markets in Crypto-Assets Regulation (MiCAR) in the EU and passage of the GENIUS Act in the US have bolstered the acceptance of stablecoins by requiring them to be backed by reserve assets. The stablecoin market capitalization is comparatively small relative to unbacked crypto-assets (for example, Bitcoin) which dominate the crypto ecosystem. Euro-referenced stablecoins have, however, grown rapidly (Box Figure 2.1).

Stablecoins and tokenization have the potential to enhance financial access and efficiency. In addition to their main role in the settlement of unbacked crypto-assets trading, stablecoins are used for cross-border payments—notably, remittances—offering a faster and cheaper alternative to correspondent banking networks. By contrast, their prospective use for domestic retail payments, especially in advanced Europe, appears limited in the presence of efficient payments systems and low transaction costs (Box Figure 2.2).³

But they also bring risks and new policy challenges. These include (i) a rise in illicit activities such as money laundering due to their anonymity; (ii) the potential for rapid capital flight, financial disintermediation and further dollarization in cases of price and currency instability (for example, Russia and Türkiye), and (iii) challenges of monetary policy implementation (Box Figure 2.3). A widespread use of US dollar-referenced stablecoins could strengthen the global role of the US dollar, weakening monetary transmission to the real economy in other economies.⁴ The composition of stablecoins' reserve assets may also steepen yield curves and raise bank funding costs. For these reasons, the growing use of stablecoins and other crypto assets raises macro-relevant issues.

Policymakers should focus on establishing robust legal and regulatory frameworks that enable financial innovation while safeguarding macro-financial stability. While the EU's MiCAR has been implemented, several other European jurisdictions still need to develop regulations for stablecoins and crypto activities. Going forward, other policy priorities include:

- **Ensuring cross-jurisdiction fungibility of stablecoins.** Stablecoins are essentially borderless, but different regulatory requirements complicate cross-jurisdiction fungibility (Box Figure 2.4). In the context of MiCAR, reserve assets of stablecoins issued in the EU are essentially ringfenced. As some firms issue EU-compliant stablecoins under the same name as globally marketed products, their interchangeability is a challenge that needs to be addressed. An international standard on stablecoins, as well as supervisory cooperation, could help reduce the need for such ringfencing of reserve assets.
- **Adapting the AML/CFT regulatory and supervisory approach to ensure effectiveness in a new financial landscape.** Even though crypto-asset service providers are subject to AML/CFT regimes, crypto-assets can be transferred without being routed through bank accounts, weakening financial intermediaries' ability to ensure know-your-customer compliance. The monitoring of suspicious activity therefore would need to include transaction patterns in addition to account identities.⁵

¹ Prepared by Phakawa Jeasakul and Valentina Semenova.

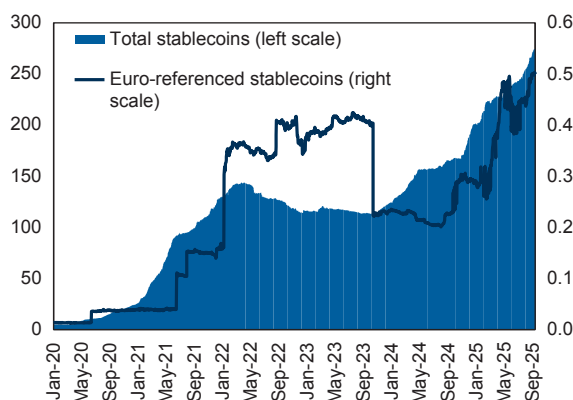
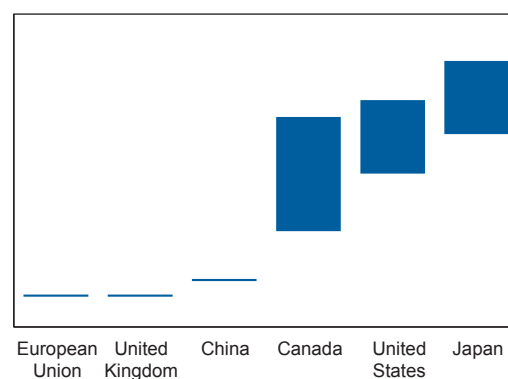
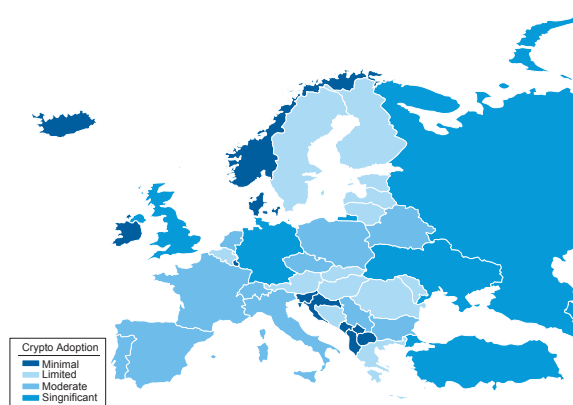
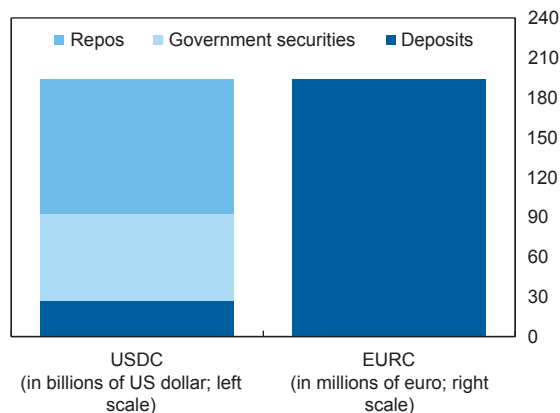
² Stablecoins are a form of tokenized assets, typically using blockchain technology, with an aim to maintain a stable value (usually relative to a currency). Tokenization is the process of creating a digital representation of real-world assets.

³ For example, the TARGET Instant Payment Settlement (TIPS) can process fund transfers instantly with low costs using central bank money.

⁴ See further discussion in the IMF's work on the integrated policy framework.

⁵ See further discussion in BIS's Annual Economic Report, 2025.

Box 2. (continued)

Box Figure 2.1. Stablecoins: Market Capitalization*(In billions of US dollars)***Box Figure 2.2. Selected Economies: Credit Card Interchange Fees, 2024***(In percent of transaction value)***Box Figure 2.3. Europe: Crypto Adoption***(Based on in-person retail transactions in percent)***Box Figure 2.4. Selected Stablecoins: Composition of Reserve Assets, June 2025**

Sources: Chainalysis.com; CoinGenko.com; Federal Reserve Bank of Kansas City; Circle; and IMF Staff calculations.

Note: In panel 1, historical data on euro-referenced stablecoins showed few sharp changes, reflecting additions or removals of some stablecoins. In panel 2, interchange fees are transaction fees that merchants pay to card-issuing banks. The total transaction costs are higher as there are additional fees charged by acquiring banks, payment processors, card networks and service providers. In panel 3, crypto adoption is based on (total and retail) inflows into on-chain centralized and decentralized protocols relative to per capita income. The color scheming (and classification) is based on percentile ranking of crypto adoption. In panel 4, USDC is the second largest US dollar-referenced stablecoins; EURC is the largest euro-reference stablecoins. Both stable coins are issued by Circle. The chart shows the actual composition of reserve assets and may over/understate the requirements.

- Adopting the “same activity, same risk, same regulation” approach to limit regulatory arbitrage but greater adoption of stablecoins can strengthen linkages between the traditional and crypto ecosystems. Crypto activities continue evolving rapidly, including a trend towards tokenization that could be accompanied by activities economically similar to traditional finance. The regulatory regime thus needs to adjust accordingly to safeguard financial stability. Currently, risks related to crypto-assets are

Box 2. (continued)

assessed to be not systemic.⁶ More comprehensive and frequent data reporting is needed to ensure effective risk monitoring.

Building a next-generation payment infrastructure is essential for reaping the benefits of technological innovation. To reduce settlement risks from decentralized private money, authorities could issue wholesale central bank digital currencies (CBDCs) to create the foundation for executing payments and settling blockchain-based financial transactions. The ECB's Project Pontes and Project Appia aims to build such infrastructure. Furthermore, retail CBDCs such as the digital euro could enhance retail payment systems and lower transaction costs, and their design should meet public preferences such as privacy needs and use cases.

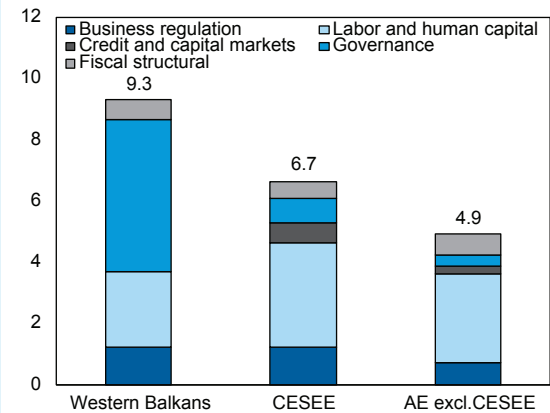
⁶ See IMF, Global Financial Stability Report, October 2021 and ESRB (2023).

Box 3. A Three-Pillar Strategy for Raising Growth in Europe¹

Structural reforms could be the solution to Europe’s growth malaise if executed and financed efficiently. A three-pronged strategy to deepen the single market—comprising reforms at the EU-, national-, and the EU-budget level—could substantially improve Europe’s growth and productivity performance (Georgieva 2025).

- Advancing national structural reforms could deliver substantial output dividends. IMF staff (Budina and others 2025) identifies five reform areas including labor, fiscal-structural, business regulation, innovation and governance. Reform gains could be substantial and are larger for countries further away from the frontier, with the largest output gains from reform efforts aimed at closing 50 percent of policy gaps over 9 percent in the Western Balkans, followed by 7 percent in CESEE countries, and about 5 percent in AE (Box Figures 3.1 and 3.2).

Box Figure 3.1. Medium-Term GDP Impact of Closing 50 Percent of Prioritized Policy Gaps (Percent)



Source: Budina and others (2025).
Note: The estimated GDP impact of each reform in a region is the regional weighted average. Western Balkans include Albania, Bosnia and Herzegovina, Kosovo, Montenegro, and North Macedonia. CESEE includes Belarus and Türkiye. AE excl. CESEE excludes San Marino.

Box Figure 3.2. Selected Reform Measures

Reform Areas	Measures
Labor and human capital	Strengthen education systems, scale up training, incentivize labor force participation, and attract and integrate foreign workers
Fiscal structural reforms	Well-designed tax policies, pension reforms, efficiency of public services, public investment management, and SOE reforms
Business regulation	Reduce the cost of regulation, reducing barriers to firm entry and exit, and easing structural obstacles to construction

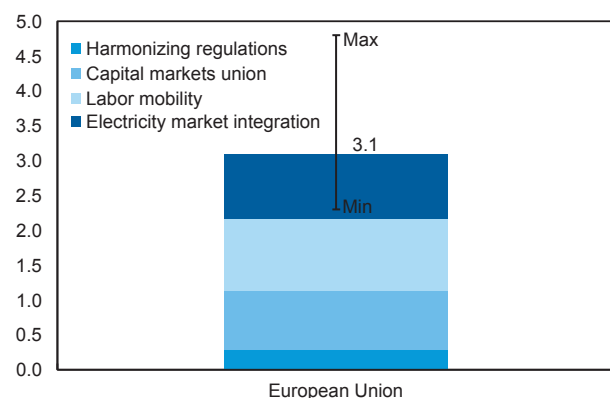
- Similarly, completing the EU single market would also yield substantial growth gains through investment and innovation, ultimately lifting productivity. Addressing four key binding constraints that hinder firms’ ability to innovate and scale up within the EU single market could have significant outcomes on growth and productivity (Arnold and others 2025). Just implementing a select set of reforms can boost the EU GDP by at least 3 percent over the next 10 years—a downpayment on the gains available from fully integrating the single market across all its dimensions (Box Figures 3.3 and 3.4). All countries stand to gain, between 2 to 5 percent of GDP.

¹ Prepared by Burcu Hacibedel.

Box 3. (continued)

Box Figure 3.3. Illustrative Simulations: Long-Term Gains from Select EU-Level Reforms

(Percentage change in potential output in 2035 relative to the baseline)



Sources: Arnold and others (2025); and IMF Staff calculations.

Note: Panel 3 shows the range from implementing a set of selected reforms to advance the integration of the EU's single market among 12 countries (Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Portugal, Spain, and Sweden) and rest of the European Union. "Harmonizing regulation" stands for adoption of a unified high-quality insolvency regime across all members; "Capital markets union" for a higher share of Venture Capital investment by insurance corporations and pension funds; "Labor mobility" for higher within EU labor mobility and improved skill matching; and "Electricity market integration" for lower electricity prices from a single energy market. For details see Arnold and others (2025).

Box Figure 3.4. Ten Actionable Priorities the Four Areas of Single Market Reform

Streamline Regulations

1. Introduce a 28th regime
2. Use EU Regulations over Directives

Advance Capital Markets Union

3. Expand EU venture capital
4. Promote automatic enrollment in private pensions
5. Review Pan-European Personal Pension Product Regulation

Enable Labor Mobility

6. Digitize and simplify professional qualification recognition
7. Improve social security coordination and pension portability
8. Address housing shortages and expand language training

Integrate Energy Systems

9. Develop EU energy blueprint
10. Strengthen institutional frameworks and long-term planning

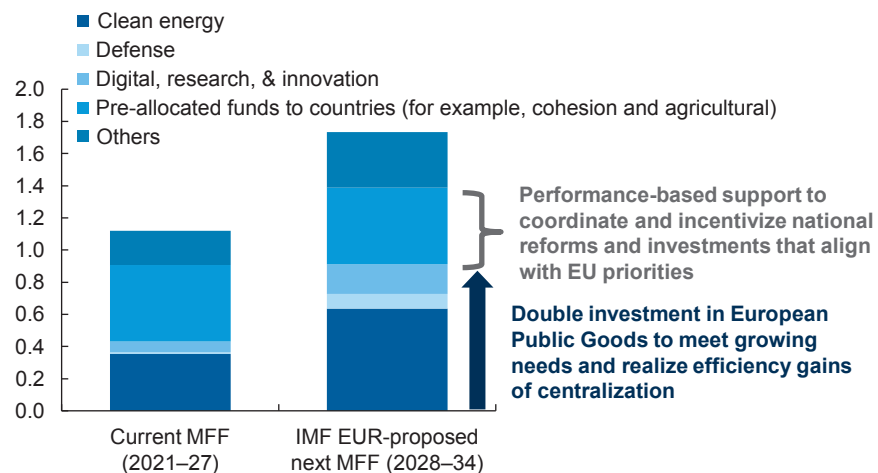
The interaction and complementarity between national-level structural reforms and EU-level reforms are key for maximizing their impact. National reforms could amplify the effects of EU-level reforms. For instance, improving domestic labor market and human capital would have positive effects on EU-wide efforts targeting R&D policies. Likewise, labor market and pension reforms could enhance EU-wide labor mobility. EU-level reforms could also amplify gains from national reforms. For example, progress on the CMU, lowering intra-EU trade barriers and advancing single energy market would amplify effects of national reforms. These complementarities highlight the importance of a coordinated push at both national and EU levels, as exploiting these synergies can significantly enhance the effectiveness of the reforms.

A fresh look at the budget would help facilitate investment in European public goods and align EU priorities with national reforms. The EU budget, formally called the Multiannual Financial Framework (MFF), could be strategically used to serve this purpose (Busse and others 2025). To coordinate the national and EU-level reform efforts and strategically invest in public goods, the EU budget should be expanded and adopt a performance-driven approach (Box Figure 3.5). The next MFF (2028-2034) could provide an opportunity to transform the budget accordingly. First, spending on European Public Goods (EPGs), such as clean energy, defense, and research & innovation, should be increased from 0.4 to 0.9 percent of GNI. These areas yield cross-border benefits and economies of scale, and centralized EU-level investment would be more efficient than fragmented national efforts. For instance, a strong, integrated energy grid would not only support cheaper and more reliable energy provision, but also AI-related future energy needs. Secondly, the budget should be streamlined and made more responsive to evolving needs. This includes consolidating overlapping programs, enhancing flexibility to respond to shocks, and expanding performance-based budgeting to incentivize reforms and efficient spending.

Box 3. (continued)

Thirdly, the EU should integrate borrowing as a regular financing tool, supported by increased own resources (e.g., from emissions trading and border adjustment mechanisms). This would allow for a larger budget envelope without overburdening national contributions and help develop EU safe assets to strengthen financial markets.

Box Figure 3.5. IMF Proposal for MFF



Source: IMF based on European Commission.

Note: IMF EUR = IMF European department; GNI = Gross National Income; MFF = Multiannual Financial Framework.

References

- Adhikari, Bibek, Romain Duval, Bingjie Hu, and Prakash Loungani. 2018. "Can Reform Waves Turn the Tide? Some Case Studies Using the Synthetic Control Method." *Open Economies Review* 29 (4): 1–32.
- Adilbish, Oyun Erdene, Diego A. Cerdeiro, Romain A. Duval, Gee Hee Hong, Luca Mazzone, Lorenzo Rotunno, Hasan H. Toprak, and Maryam Vaziri. 2025. "Europe's Productivity Weakness." IMF Working Paper No. 25/40, International Monetary Fund.
- Arnold, Nathaniel, Allan Dizioli, Alexandra Fotiou, Jan Frie, Burcu Hacibedel, Tara Iyer, Huidan Lin, Malhar Nabar, Hui Tong, and Frederik Toscani. 2025. "Lifting Binding Constraints on Growth in Europe." IMF Working Paper No. 25/113, International Monetary Fund.
- Baker, Scott R., Nicholas Bloom, and Steven J. Davis. 2016. "Measuring Economic Policy Uncertainty." *Quarterly Journal of Economics* 131 (4): 1593–636.
- Banerjee, Abhijit, Rukmini Banerji, James Berry, Esther Duflo, Harini Kannan, Shobhini Mukerji, Marc Shotland, and Michael Walton. 2017. "From Proof of Concept to Scalable Policies: Challenges and Solutions, with an Application." *Journal of Economic Perspectives* 31 (4): 73–102.
- Beyer, R. Tong, H., and Zhou X. (forthcoming). Trade Policy Shocks and Corporate Valuations in Europe – Disentangling Trade and Uncertainty Channels. IMF Working Paper.
- Beyer, Robert C. M., Claire Li, and Sebastian Weber. 2025. "Economic Benefits from Deep Integration: Twenty Years after the 2004 EU Enlargement." IMF Working Paper 25/047, International Monetary Fund.
- Boehm, Christoph E., Andrei A. Levchenko, and Nitya Pandalai-Nayar. 2023. "The Long and Short (Run) of Trade Elasticities." *American Economic Review* 113 (4): 861–905.
- Budina, Nina, Oyun Erdene Adilbish, Diego A. Cerdeiro, Romain A. Duval, Balázs Égert, Dmitriy Kovtun, Anh Thi Ngoc Nguyen, Augustus J. Panton, and Michelle Tejada. 2025. "Europe's National Level Structural Reform Priorities." IMF Working Paper No. 25/104, International Monetary Fund.
- Busse, M., Lin, H., Nabar, M. and Yoo, J., 2025. Making the EU's Multiannual Financial Framework Fit for Purpose. IMF Working Paper No. 2025/114
- Caldara, Dario & Iacoviello, Matteo & Molligo, Patrick & Prestipino, Andrea & Raffo, Andrea, 2020. "The economic effects of trade policy uncertainty," *Journal of Monetary Economics*, Elsevier, vol. 109(C), pages 38–59.
- Claessens, Stijn, M. Ayhan Kose, and Marco E. Terrones. 2012. "How Do Business and Financial Cycles Interact?" *Journal of International Economics* 87 (1): 178–90.
- Dizioli, Allan. 2025. "Interest Rate Sensitivity Scenarios to Guide Monetary Policy." IMF Working Paper No. 25/107, International Monetary Fund.
- Draghi, Mario. 2024. "The Future of European Competitiveness—A Competitiveness Strategy for Europe." European Commission.
- Duval, Romain, Gee Hee Hong, and Yannick Timmer. 2020. "Financial Frictions and the Great Productivity Slowdown." *The Review of Financial Studies* 33 (2): 475–503.

Eble, Stephanie, Alexander Pitt, Irina Bunda, Oyun Erdene Adilbish, Nina Budina, Gee Hee Hong, Moheb T. Malak, Sabiha Mohona, Alla Myrvoda, and Keyra Primus. 2025. "Long-Term Spending Pressures in Europe: An IMF Analysis," International Monetary Fund.

ESRB 2023 Annual Report

EuroFi. 2025. *EuroFi Monetary Scoreboard*, April 2025.

European Central Bank. 2025. "Financial Stability Review." Frankfurt, May.

Fabbrini, Federico. 2019. "The Future of the EU 27." In Federico Fabbrini (Ed.), *The Brexit Negotiations and the May Government: Special issue* (Vol. 12). European Journal of Legal Studies, BRIDGE Network—Working Paper.

Georgieva, K. 2025. "Deepening the European Single Market"

IMF. 2019. "Reigniting Growth in Emerging Market and Low-Income Economies: What Role for Structural Reforms?" (Chapter 3). In *World Economic Outlook*. International Monetary Fund, October.

IMF. 2024a. "Denmark: 2024 Article IV Consultation, International Monetary Fund." Retrieved from Denmark: 2024 Article IV Consultation-Press Release; Staff Report; and Statement by the Alternate Executive Director for Denmark.

IMF. 2024b. "Understanding the Social Acceptability of Structural Reforms" (Chapter 3). In *World Economic Outlook*. International Monetary Fund October 2024.

IMF 2024c. *Regional Economic Outlook for Europe: A Recovery Short of Europe's Full Potential*. Washington, DC, October 2024.

IMF. 2025a. "Public Sentiment Matters: The Essence of Successful Energy Subsidies and Pension Reforms" (Chapter 2). In *Fiscal Monitor*. International Monetary Fund.

IMF. 2025b "Euro Area Policies: Financial System Stability Assessment", IMF Staff Country Reports 2025, 203.

IMF. 2025c. "Global Prospects and Policies" (Chapter 1). In *World Economic Outlook*. International Monetary Fund October 2025.

IMF 2025d. "Fiscal Monitor" (Chapter 1). In *Fiscal Monitor* International Monetary Fund October 2025.

IMF 2025e. "Beneath the Calm, Shifting Ground: Stability Challenges Amid Changes in Financial Markets" (Chapter 1). In *Global Financial Stability Report*. International Monetary Fund October 2025.

IMF. 2025f. ""Emerging Market Resilience: Good Luck or Good Policies?" (Chapter 2). In *World Economic Outlook*. International Monetary Fund October 2025.

Kammer, A. 2025a. "National-level Priorities to Lift Growth in the EU: Why, What, and How," Remarks at the EU's Economic and Financial Committee, Copenhagen

Kammer, A. 2025b. "Europe's Integration Imperative", Finance and Development, June 2025

Lane, P. 2024. *ECB's Economic Bulletin* (4th Issue). European Central Bank.

Letta, Enrico. 2024. "Much More Than a Market." European Commission.

Misch, Florian, Ben Park, Carlo Pizzinelli, and Galen Sher. 2025. "Artificial Intelligence and Productivity in Europe." IMF Working Paper 25/67, International Monetary Fund.

Tompson, William, and Thai Thanh Dang. 2010. "Advancing Structural Reforms in OECD Countries: Lessons from Twenty Case Studies." Organization for Economic Co-operation and Development.

Annex Table 1.1 Real GDP Growth*(Year-over-year percent change; aggregation based on GDP in purchasing power parity terms)*

	October 2025 WEO				April 2025 WEO			Difference		
	2024	2025	2026	2027	2025	2026	2027	2025	2026	2027
Europe	1.9	1.5	1.6	1.8	1.4	1.6	1.7	0.1	0.0	0.1
Advanced European Economies	1.1	1.3	1.3	1.5	1.0	1.3	1.4	0.3	0.0	0.1
Euro Area	0.9	1.2	1.1	1.4	0.8	1.2	1.3	0.4	-0.1	0.1
Austria	-1.0	0.3	0.8	1.6	-0.3	0.8	1.6	0.6	0.0	0.0
Belgium	1.0	1.1	1.0	1.3	0.8	1.0	1.2	0.3	0.0	0.1
Croatia	3.9	3.1	2.7	2.6	3.1	2.7	2.6	0.0	0.0	0.0
Cyprus	3.4	2.9	2.8	2.8	2.5	2.7	3.0	0.4	0.1	-0.2
Estonia	-0.1	0.5	1.5	1.8	0.7	1.8	1.8	-0.2	-0.3	0.0
Finland	0.4	0.5	1.3	1.3	1.0	1.4	1.4	-0.5	-0.1	-0.1
France	1.1	0.7	0.9	1.2	0.6	1.0	1.2	0.1	-0.1	0.0
Germany	-0.5	0.2	0.9	1.5	0.0	0.9	1.5	0.2	0.0	0.0
Greece	2.3	2.0	2.0	1.5	2.0	1.8	1.3	0.0	0.2	0.2
Ireland	2.6	9.1	1.3	2.5	2.3	2.1	2.1	6.8	-0.8	0.4
Italy	0.7	0.5	0.8	0.6	0.4	0.8	0.6	0.1	0.0	0.0
Latvia	-0.4	1	2.2	2.4	2	2.5	2.5	-1.0	-0.3	-0.1
Lithuania	2.7	2.7	2.9	2.1	2.8	2.5	2.5	-0.1	0.4	-0.4
Luxembourg	0.4	1.2	2.1	2.3	1.6	2.2	2.3	-0.4	-0.1	0.0
Malta	6.8	3.9	3.9	4.0	3.9	3.9	4	0.0	0.0	0.0
Netherlands, The	1.1	1.4	1.2	1.4	1.4	1.4	1.4	0.0	-0.2	0.0
Portugal	1.9	1.9	2.1	1.5	2	1.7	1.5	-0.1	0.4	0.0
Slovak Republic	2.1	0.9	1.7	2.5	1.3	1.7	2.5	-0.4	0.0	0.0
Slovenia	1.7	1.1	2.3	2.5	1.8	2.4	2.5	-0.7	-0.1	0.0
Spain	3.5	2.9	2.0	1.7	2.5	1.8	1.7	0.4	0.2	0.0
Nordic Economies	1.9	1.2	1.9	1.7	2.2	1.9	1.7	-1.0	0.0	0.0
Denmark	3.5	1.8	2.2	1.6	2.9	1.8	1.6	-1.1	0.4	0.0
Iceland	-1	1.4	2.3	2.4	2.0	2.4	2.5	-0.6	-0.1	-0.1
Norway	2.1	1.2	1.6	1.6	2.1	1.7	1.6	-0.9	-0.1	0.0
Sweden	0.8	0.7	1.9	1.8	1.9	2.2	1.9	-1.2	-0.3	-0.1
Other European Advanced Economies	1.1	1.5	1.6	1.7	1.3	1.7	1.7	0.2	-0.1	0.0
Andorra	3.4	2.4	1.6	1.5	1.9	1.6	1.5	0.5	0.0	0.0
Czech Republic	1.2	2.3	2.0	2.0	1.6	1.8	1.9	0.7	0.2	0.1
Israel	1.0	2.5	3.9	3.3	3.2	3.6	3.3	-0.7	0.3	0.0
San Marino	0.7	1.0	1.3	1.2	1.0	1.3	1.2	0.0	0.0	0.0
Switzerland	1.4	0.9	1.3	1.1	0.9	1.6	1.2	0.0	-0.3	-0.1
United Kingdom	1.1	1.3	1.3	1.5	1.1	1.4	1.5	0.2	-0.1	0.0

	October 2025 WEO				April 2025 WEO			Difference		
	2024	2025	2026	2027	2025	2026	2027	2025	2026	2027
European Emerging Market Economies	3.5	1.8	2.2	2.4	2.1	2.1	2.3	-0.3	0.1	0.1
Central Europe	2.5	2.8	2.9	2.7	2.9	3.0	3.0	-0.1	-0.1	-0.3
Hungary	0.5	0.6	2.1	2.3	1.4	2.6	2.8	-0.8	-0.5	-0.5
Poland	2.9	3.2	3.1	2.9	3.2	3.1	3.0	0.0	0.0	-0.1
Eastern Europe	4.2	0.8	1.3	1.5	1.5	1.2	1.5	-0.7	0.1	0.0
Belarus	4.0	2.1	1.4	1.6	2.8	2	1.4	-0.7	-0.6	0.2
Moldova	0.1	1.7	2.2	3.5	0.6	2.5	5	1.1	-0.3	-1.5
Russia	4.3	0.6	1.0	1.1	1.5	0.9	1.1	-0.9	0.1	0.0
Ukraine	2.9	2.0	4.5	4.8	2.0	4.5	4.8	0.0	0.0	0.0
Southeastern European EU Member States	1.3	1.4	1.8	2.8	1.8	2.7	3.1	-0.4	-0.9	-0.3
Bulgaria	2.8	3.0	3.1	2.8	2.5	2.7	2.7	0.5	0.4	0.1
Romania	0.8	1.0	1.4	2.7	1.6	2.8	3.2	-0.6	-1.4	-0.5
Southeastern European Non-EU Member States	3.6	2.8	3.4	3.9	3.4	3.7	3.8	-0.6	-0.3	0.1
Albania	4.0	3.4	3.6	3.5	3.8	3.5	3.5	-0.4	0.1	0.0
Bosnia and Herzegovina	3.0	2.4	2.7	3.0	2.8	3.0	3.0	-0.4	-0.3	0.0
Kosovo	4.6	3.9	4.0	3.9	4.0	4.0	3.9	-0.1	0.0	0.0
Montenegro	3.2	3.2	3.2	3.0	3.2	3.2	3.0	0.0	0.0	0.0
North Macedonia	2.8	3.4	3.2	3.2	3.2	3.2	3.2	0.2	0.0	0.0
Serbia	3.9	2.4	3.6	4.6	3.5	4.2	4.5	-1.1	-0.6	0.1
Türkiye	3.3	3.5	3.7	3.7	2.7	3.2	3.4	0.8	0.5	0.3
<i>Memorandum</i>										
World	3.3	3.2	3.1	3.2	2.8	3	3.2	0.4	0.1	0.0
Advanced Economies	1.8	1.6	1.6	1.7	1.4	1.5	1.7	0.2	0.1	0.0
Emerging Market and Developing Economies	4.3	4.2	4	4.2	3.7	3.9	4.2	0.5	0.1	0.0
Emerging and Developing Europe	3.5	1.8	2.2	2.4	2.1	2.1	2.3	-0.3	0.1	0.1
Emerging Europe, excluding Belarus, Russia, Türkiye, and Ukraine	2.2	2.4	2.7	2.9	2.6	3.0	3.1	-0.2	-0.3	-0.2
European Union	1.1	1.4	1.4	1.6	1.2	1.5	1.6	0.2	-0.1	0.0
United States	2.8	2.0	2.1	2.1	1.8	1.7	2.0	0.2	0.4	0.1
China	5.0	4.8	4.2	4.2	4.0	4.0	4.2	0.8	0.2	0.0
Japan	0.1	1.1	0.6	0.6	0.6	0.6	0.6	0.5	0.0	0.0

Sources: IMF, World Economic Outlook (WEO) database; and IMF staff calculations.

Annex Table 1.2. Headline Inflation*(Year-over-year percent change; aggregation based on GDP in purchasing power parity terms)*

	October 2025 WEO				April 2025 WEO			Difference		
	2024	2025	2026	2027	2025	2026	2027	2025	2026	2027
Europe	7.8	6.2	4.5	3.9	6.2	4.3	3.6	0.0	0.2	0.3
Advanced European Economies	2.4	2.2	2.0	2.0	2.2	2.0	2.0	0.0	0.0	0.0
Euro Area	2.4	2.1	1.9	2.1	2.1	1.9	2.0	0.0	0.0	0.1
Austria	2.9	3.6	2.3	2.2	3.2	1.7	2.2	0.4	0.6	0.0
Belgium	4.3	2.6	1.3	1.9	3.2	2.1	2.1	-0.6	-0.8	-0.2
Croatia	4.0	4.4	2.8	2.4	3.7	2.6	2.2	0.7	0.2	0.2
Cyprus	2.3	0.7	1.3	2.0	2.3	2.0	2.0	-1.6	-0.7	0.0
Estonia	3.7	5.1	4.3	3.3	5.8	3.9	3.2	-0.7	0.4	0.1
Finland	1.0	1.8	1.9	2.0	2.0	2.0	2.0	-0.2	-0.1	0.0
France	2.3	1.1	1.5	1.9	1.3	1.6	1.9	-0.2	-0.1	0.0
Germany	2.5	2.1	1.8	2.0	2.1	1.9	2.1	0.0	-0.1	-0.1
Greece	3.0	3.1	2.5	2.6	2.4	2.1	2.0	0.7	0.4	0.6
Ireland	1.3	1.7	1.7	1.8	1.9	1.7	1.8	-0.2	0.0	0.0
Italy	1.1	1.7	2.0	2.0	1.7	2.0	2.0	0.0	0.0	0.0
Latvia	1.3	3.8	2.6	2.8	2.4	2.4	2.6	1.4	0.2	0.2
Lithuania	0.9	3.6	3.1	2.5	3.5	2.8	2.6	0.1	0.3	-0.1
Luxembourg	2.3	2.3	2.2	2.0	2.2	2.1	2.0	0.1	0.1	0.0
Malta	2.4	2.4	2.0	2.0	2.1	1.9	2.1	0.3	0.1	-0.1
Netherlands, The	3.2	2.9	2.4	2.4	2.8	2.3	2.0	0.1	0.1	0.4
Portugal	2.7	2.2	2.1	2.2	1.9	2.1	2.0	0.3	0.0	0.2
Slovak Republic	3.2	4.2	3.3	2.2	3.7	2.9	2.2	0.5	0.4	0.0
Slovenia	2.0	2.5	2.4	2.2	2.6	2.3	2.2	-0.1	0.1	0.0
Spain	2.9	2.4	2.0	2.5	2.2	2.0	2.1	0.2	0.0	0.4
Nordic Economies	2.2	2.3	2.0	2.0	2.2	2.1	2.0	0.1	-0.1	0.0
Denmark	1.3	1.9	2.1	2.0	1.9	2.1	2.0	0.0	0.0	0.0
Iceland	5.9	4.2	3.1	2.5	3.5	2.7	2.5	0.7	0.4	0.0
Norway	3.1	2.4	2.4	2.0	2.6	2.2	2.0	-0.2	0.2	0.0
Sweden	2.0	2.3	1.6	1.9	2.1	2.0	2.0	0.2	-0.4	-0.1
Other European Advanced Economies	2.4	2.9	2.2	1.9	2.6	2.0	1.8	0.3	0.2	0.1
Andorra	3.1	2.2	1.8	1.7	2.2	1.8	1.7	0.0	0.0	0.0
Czech Republic	2.4	2.5	2.3	2.3	2.5	2.0	2.0	0.0	0.3	0.3
Israel	3.1	3.2	2.2	2.2	2.7	2.0	2.1	0.5	0.2	0.1
San Marino	1.2	2.0	2.0	2.0	2.0	2.0	2.0	0.0	0.0	0.0
Switzerland	1.1	0.1	0.6	0.7	0.2	0.5	0.7	-0.1	0.1	0.0
United Kingdom	2.5	3.4	2.5	2.0	3.1	2.2	2.0	0.3	0.3	0.0

	October 2025 WEO				April 2025 WEO			Difference		
	2024	2025	2026	2027	2025	2026	2027	2025	2026	2027
European Emerging Market Economies	18.7	14.1	9.6	7.6	14.1	9.0	6.7	0.0	0.6	0.9
Central Europe	3.7	3.9	2.9	2.8	4.4	3.4	2.9	-0.5	-0.5	-0.1
Hungary	3.7	4.5	3.5	3.0	4.9	3.6	3.2	-0.4	-0.1	-0.2
Poland	3.7	3.8	2.8	2.7	4.3	3.4	2.9	-0.5	-0.6	-0.2
Eastern Europe	8.2	9.2	5.5	4.2	9.4	5.7	4.2	-0.2	-0.2	0.0
Belarus	5.7	7.0	7.5	6.4	5.5	5.8	5.7	1.5	1.7	0.7
Moldova	4.7	7.7	5.5	5.0	8.0	5.9	5.0	-0.3	-0.4	0.0
Russia	8.4	9.0	5.2	4.0	9.3	5.5	4.0	-0.3	-0.3	0.0
Ukraine	6.5	12.6	7.6	5.3	12.6	7.7	5.3	0.0	-0.1	0.0
Southeastern European EU Member States	4.9	6.5	5.9	4.0	4.4	2.9	3.0	2.1	3.0	1.0
Bulgaria	2.6	3.6	3.4	2.8	3.7	2.3	2.2	-0.1	1.1	0.6
Romania	5.6	7.3	6.7	4.3	4.6	3.1	3.3	2.7	3.6	1.0
Southeastern European Non-EU Member States	3.4	4.0	3.3	2.9	3.3	2.8	2.7	0.7	0.5	0.2
Albania	2.2	2.3	2.8	3.0	2.4	2.7	3.0	-0.1	0.1	0.0
Bosnia and Herzegovina	1.7	4.0	2.6	2.0	2.2	2.0	2.0	1.8	0.6	0.0
Kosovo	1.6	3.5	2.7	2.1	2.2	1.9	2.0	1.3	0.8	0.1
Montenegro	3.3	4.1	2.3	2.3	3.3	2.9	2.0	0.8	-0.6	0.3
North Macedonia	3.5	3.9	3.0	2.2	3.4	2.2	2.0	0.5	0.8	0.2
Serbia	4.7	4.6	4.0	3.6	4.0	3.3	3.3	0.6	0.7	0.3
Türkiye	58.5	34.9	24.7	19.5	35.9	22.8	16.5	-1.0	1.9	3.0
<i>Memorandum</i>										
World	5.8	4.2	3.7	3.4	4.3	3.6	3.3	-0.1	0.1	0.1
Advanced Economies	2.6	2.5	2.2	2.1	2.5	2.2	2.0	0.0	0.0	0.1
Emerging Market and Developing Economies	7.9	5.3	4.7	4.2	5.5	4.6	4.1	-0.2	0.1	0.1
Emerging and Developing Europe	16.9	13.5	9.3	7.4	13.5	8.7	6.6	0.0	0.6	0.8
Emerging Europe, excluding Belarus, Russia, Türkiye, and Ukraine	4.0	4.7	3.8	3.1	4.3	3.2	3.0	0.4	0.6	0.1
European Union	2.6	2.4	2.2	2.2	2.4	2.1	2.2	0.0	0.1	0.0
United States	3.0	2.7	2.4	2.2	3.0	2.5	2.1	-0.3	-0.1	0.1
China	0.2	0.0	0.7	1.4	0.0	0.6	1.4	0.0	0.1	0.0
Japan	2.7	3.3	2.1	2.0	2.4	1.7	2.0	0.9	0.4	0.0

Sources: IMF, World Economic Outlook (WEO) database; and IMF staff calculations.

