

Research Briefing | Eurozone

EU recovery spending should continue after 2026

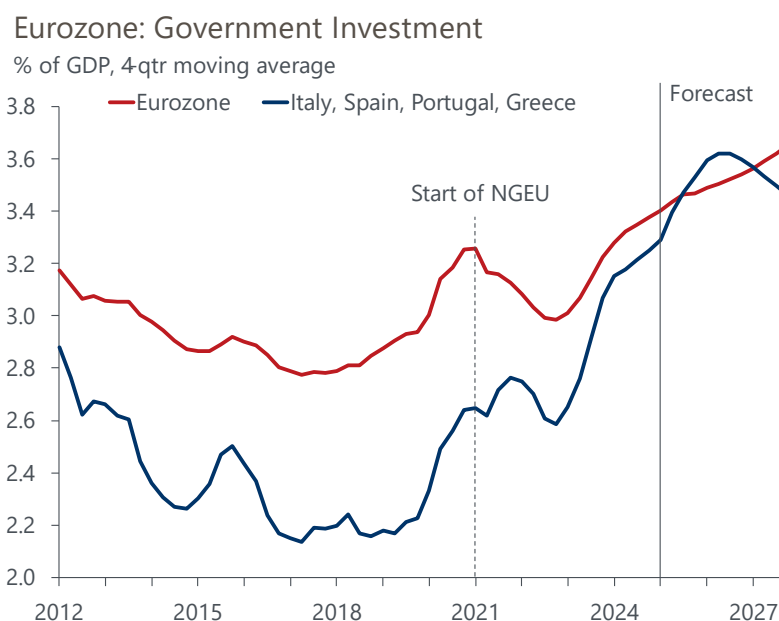
- Southern European economies face the threat of a steep fiscal cliff in 2027. The EU Commission plans to end payments from the EU recovery fund by the end of 2026. Unspent funds are worth 6% of GDP, so a full absorption looks impossible in this timeframe. But we think spending will continue after 2026 and the periphery's recent growth outperformance won't abruptly end.
- We had been sceptical since the inception of the Next Generation EU stimulus package that countries would manage to absorb the massive fiscal transfers in the planned timeframe. News reports and official statements support our view that a combination of funds reallocation and financial engineering will safeguard the funds. However, this is subject to the remaining projects being approved over the coming month and completing agreed targets by August 2026.
- The large residual funds and the tepid implementation so far add downside risks to our outlook. GDP growth across the four main Southern EU countries could be 0.5ppts below our baseline in 2027 if progress remains lacklustre and only 30% of the spending in the baseline is implemented from 2027.

The timetable for NGEU spending is quite strict. All Recovery and Resilience Facility (RRF) milestones and targets must be completed by August 31 next year, payment requests need to be submitted by September, and all assessments and payments to member states must be finalised by the end of 2026 (**Chart 2**).

Only around 40% of the recovery fund is reported to have been spent by the four main Southern European economies (Italy, Spain, Portugal, and Greece) since the creation of the programme in 2021. There is a clear risk of a fiscal cliff for 2027 if the NGEU programme abruptly ends next year.

The end of NGEU spending would be detrimental for these four countries because it could signal a return to the subdued government investment trends observed prior to the implementation of the programme (see **Charts 1** and **4**). The NGEU programme has been the principal driver behind narrowing the government investment gap with the rest of the Eurozone. But we expect some leeway to finalise those investments beyond next year, subject to completing agreed milestones and targets by mid-2026.

Chart 1: NGEU was behind a recovery in government investment in Southern Europe



Sources: Oxford Economics, Haver Analytics

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Looking more closely at those countries' absorption, the latest figures at the end of September indicated the Italian government had spent around 45% of its allocation, Spain just a third at the end of June, Portugal 40% by September, and Greece just below half by end of April.

Chart 2: NGEU project approval and fund disbursement schedule

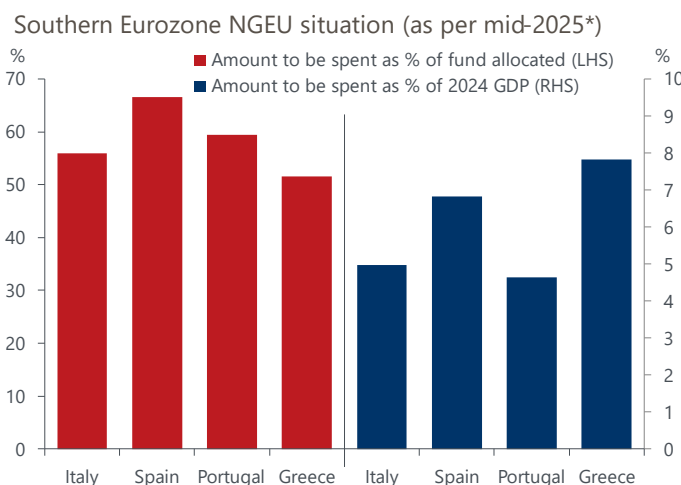


Source: Oxford Economics

While new official figures to be released in the coming months will likely show spending gained pace in the final part of this year, governments still have a long way to go. Indeed, as a percentage of the fund allocated, on average around 60% of the projects still need to be completed across all the four economies (**Chart 3**). On this metric, Spain stands out as the laggard, with around 65% of its requested funds still unspent. Meanwhile, Greece has about 50% left to spend. Italy and Portugal fall somewhere in between.

But compared to the size of its economy, Greece is lagging the other three Southern Eurozone economies, with around 8% of GDP of its allocated funds yet to be spent. This compares to 7% of GDP for Spain and around 5% for Italy and Portugal.

Chart 3: Around 6% of GDP for these four countries still needs to be spent



*Data for Portugal and Italy end in September, for Spain in June and for Greece in April

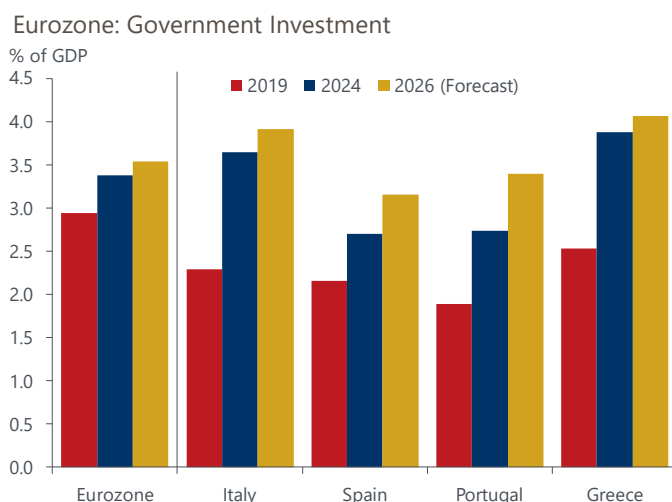
Source: Oxford Economics

However, countries are making some final changes to their programmes to minimise the amount of funds left unused. This aligns with the EC's communication from this summer, in which member states are explicitly invited to swiftly revise their programmes to meet deadlines, replacing unfeasible measures. Options presented by the European Commission included scaling up existing projects, reallocating funds to InvestEU, and splitting projects with national and EU funds.

For instance, Italy broadly maintains the overall structure of the plan in its recently announced revision, redistributing around €15bn of resources (7% of the full envelope) and strengthening some chapters and incorporating them into projects financed by cohesion funds or other projects, such as InvestEU.

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Chart 4: NGEU has supported a strong shift in government investment

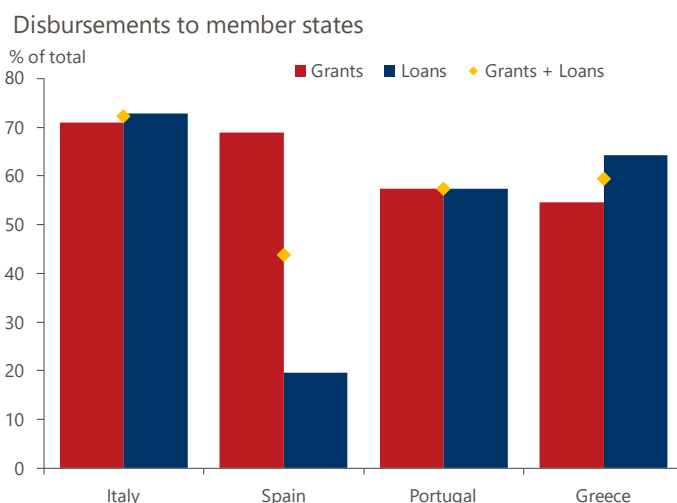


Sources: Oxford Economics, Haver Analytics

Even if the official deadline for the disbursement from the EU will remain at the end of next year, newspaper articles have reported that some beneficiary countries, such as Italy and Spain, are proceeding with the creation of some special purpose vehicles (SPV) to fund the post-2026 spending. We lack some details, but this means that there are already some discussions at the EU level on how to fund those expenditures after 2026. Typically, SPVs are legally separate entities used as budgetary vehicles to finance investments, often with the purpose of keeping liabilities out of the central budget.

Moreover, in its latest official document, the Italian government stated that "part of the investment expenditure linked to the NGEU will happen after 2026" – a clear signal that expenditures will continue after 2026. Other EU funds, such as the Cohesion Policy Funds, are known for repeated deadline extensions in light of their perennial delays. The comparison of those funds with the NGEU programme is not entirely accurate, but the extension of these programmes has always been the norm at the EU level.

Chart 5: Spain's take-up of NGEU money has been lower than the other countries



Sources: Oxford Economics, European Commission

A downside scenario remains a distinct possibility

While our baseline assumption sees NGEU-related spending continuing after next year, it also assumes a full absorption of funds in all the four countries except Spain, which is lagging the others in term of projects approved.

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Looking also at the disbursements so far (**Chart 5**), Spain has had a very limited take-up of the loans part of the NGEU, suggesting there is no strong political incentive to use this money given a lack of projects to finance. For this reason, in our central scenario we assume that only 70% of the €160bn Spain has initially requested will be spent.

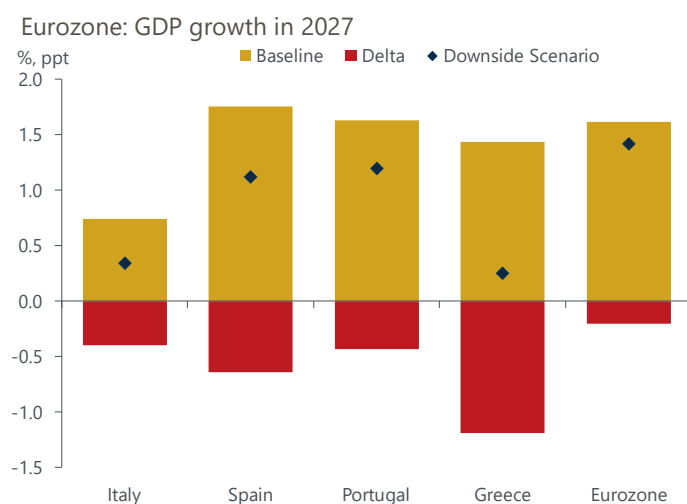
Nevertheless, there is still a risk that our baseline scenario proves too optimistic in this area. Using our Global Economic Model (GEM), we have created an alternative scenario in which we assume that from 2027 only 30% of the spending we have in our baseline takes place. This arbitrary assumption broadly fits with the slow implementation speed so far. Our modelling indicates that the aggregate GDP growth rate across the four countries in 2027 would be 0.5ppts below our baseline.

In this scenario, Greece is most affected (**Chart 6**). GDP in 2027 would stagnate. This isn't a surprise, as Greece has only allocated around 8% of GDP of the fund to be spent. Italy would also see very subdued growth at around 0.3%, broadly half of the already low growth we expect in the baseline.

On the other hand, Portugal's GDP growth would be 0.4ppts lower and Spain's would be 0.6ppts lower, but both would still be above 1%. However, in this scenario, both countries move from being two of the fastest growing economies in the Eurozone to underperforming the rest of the bloc.

The impact of a weaker performance in Southern Europe would not be huge at the Eurozone level. Eurozone GDP growth would be 0.2ppts lower in 2027 and, thanks to the strong German fiscal expansion, would still maintain a solid growth pace of around 1.5%.

Chart 6: Delays in EU fund spending would mean Italy and Greece's economies would stagnate in 2027



Source: Oxford Economics

Country Economists:

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Ricardo Amaro – Portugal

Paolo Grignani – Greece