

Southern Europe gains structural edge...

May 11, 2026 | Sovereign

...Flips the script on growth and debt

Once the continent's weak link, Southern Europe has transformed into its standout economic performer (Exhibit 1). Portugal, Spain, Cyprus, Greece, and Italy have emerged as Europe's newest economic outperformers vis-à-vis northern neighbours in growth and fiscal stability. The shift is driven by their rising primary surpluses, robust revenue, and narrowing bond spreads. Healthier structural fundamentals are reinforced by European Union (EU) funding through the Recovery and Resilience Facility (RRF), and a post-pandemic tourism boom.

This marks a dramatic reversal from the 2010-14 Eurozone debt crisis, an era defined by weak growth, high unemployment, rigid labour markets, persistent fiscal deficits, and mounting debt.

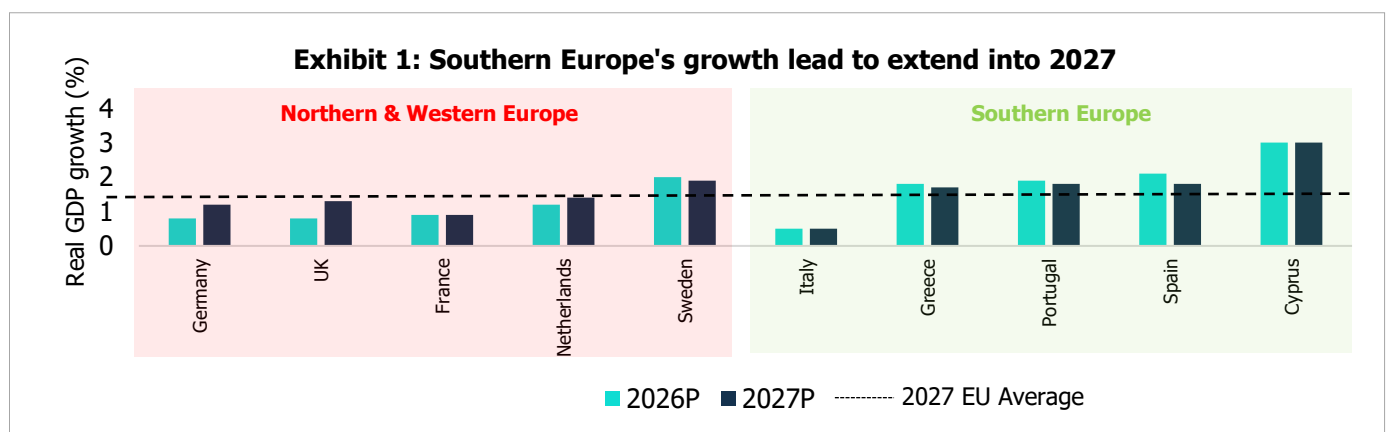
While outcomes have differed across the countries, several common trends stand out (detailed ahead):

- Stronger labour markets, reflected in falling unemployment
- Gradual diversification towards high value-added services (HVAS)
- Consolidation of government debt
- Stronger external positions, reflected in better net international investment position
- Improved competitiveness, narrowed current account deficits, and sustained surpluses in some cases

Despite these gains, important challenges remain:

- Public debt still elevated in some countries (Greece, Spain, and Italy)
- Demographic pressures are more acute in Southern Europe than in many other parts of the region
- Productivity growth continues to be modest

While recent performance reflects a meaningful improvement from post-crisis lows, credit profiles remain uneven. Portugal stands out as the strongest performer on both growth and fiscal metrics. Spain (despite slower, politically-strained fiscal consolidation) and Cyprus show robust growth. Conversely, Italy continues to lag its peers, and Greece's sharp turnaround is tempered by large debt and weaker external indicators. Overall, the region has entered a phase of structural consolidation, albeit at different speeds.



Source: IMF WEO, CGIL; Note: P = Projections

North slows, South outperforms

Europe's growth momentum has increasingly shifted southward. Several Northern and Western economies now face industrial stagnation and weaker trade performance, alongside rising debt. For instance, France and the UK have been accumulating debt amid limited political consensus to restrain social spending and increasing reliance on higher taxation. Even traditionally fiscally conservative economies, such as Germany and the Netherlands, have turned to deficit spending to support weaker growth, albeit from lower debt levels.

Southern European economies' turnaround has been led by targeted structural reforms, economic revival and sustained fiscal discipline.

Proof in numbers:

Indicators	2010-14: Crisis		2015-19: Stabilisation		2020-25: Outperformance	
	Southern Europe	Northern & Western Europe	Southern Europe	Northern & Western Europe	Southern Europe	Northern & Western Europe
GDP growth (%)	-1.2	1.1	2.0	1.9	1.8	1.0
Fiscal balance (% of GDP)	-6.5	-2.4	-2.3	-1.1	-2.8	-3.1
Primary balance (% of GDP)	-1.8	0.3	+1.6	+0.4	+0.9	-1.0
Δ Debt/GDP (%)	+5.6	+0.8	-0.6	-0.4	-1.4	+0.7
r-g (%)	+4.5	+1.2	-0.3	-0.4	-1.2	+0.3

Source: Eurostat, IMF, CGIL

Note: Southern Europe includes Cyprus, Greece, Italy, Portugal, and Spain

North and Western European economies include Germany, France, Sweden, the Netherlands, and the UK




All calculations are GDP-weighted, r= nominal effective interest rate, g= nominal GDP growth

The evolution of macro-fiscal dynamics highlights a clear turning point:

- **2010-14 (crisis):** Deep recessions, fiscal stress, rising borrowing costs, and externally imposed adjustment
- **2015-19 (stabilisation):** Gradual recovery supported by reforms, policy support from European Central Bank (ECB), and fiscal adjustment
- **2020-25 (outperformance):** Stronger growth quality, improving fiscal metrics, and sustained debt reduction

Structural reforms underpinning outperformance

Southern Europe’s improved macro-fiscal performance is underpinned by a multi-year process of structural reforms as illustrated below, largely enacted in the aftermath of the Eurozone sovereign debt crisis and sustained through the mid-to-late 2010s.

 <p>Labor market reforms</p>	 <p>Fiscal and pension reforms</p>	 <p>Banking sector reforms</p>
<p>Measures</p> <ul style="list-style-type: none"> • Shift from national to company-level wage agreements • Greater flexibility in employment contracts • Adjustments to dismissal procedures <p>Results</p> <ul style="list-style-type: none"> • Facilitated internal devaluation (enabling economies to adjust unit labour costs without exchange rate flexibility) • Strengthening of export performance • Employment-led growth • Enhanced fiscal revenues • Reduced risk of prolonged labour market rigidities during downturns • Restored competitiveness 	<p>Measures</p> <ul style="list-style-type: none"> • Increased statutory retirement ages • Tighter eligibility requirements for availing old age benefits • Stronger links between lifetime contributions and benefits • Privatisation of state-owned enterprises <p>Results</p> <ul style="list-style-type: none"> • Arrested accumulation of long-term contingent liabilities • Raised effective retirement ages and reduced unfunded pension obligations • Flattened long-term expenditure trajectories and improved debt sustainability metrics to certain extent 	<p>Measures</p> <ul style="list-style-type: none"> • Creation of bad banks • Tighter capital and liquidity norms along with ECB-led supervision • Resolution of weak banks <p>Results</p> <ul style="list-style-type: none"> • Stronger capital positions • Reduced systemic risk • Sharp decline in NPLs • Healthier bank balance sheets

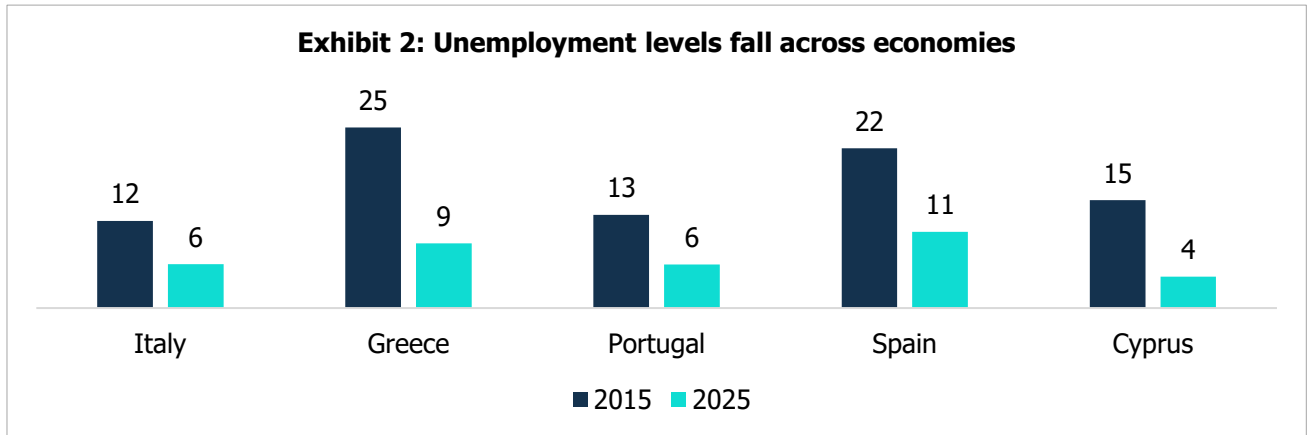
Source: CGIL

Growth more structural than temporary

Southern Europe’s recent growth is due to real structural changes and supportive cyclical tailwinds; it is not just a temporary rebound.

A. Fall in unemployment supports domestic demand

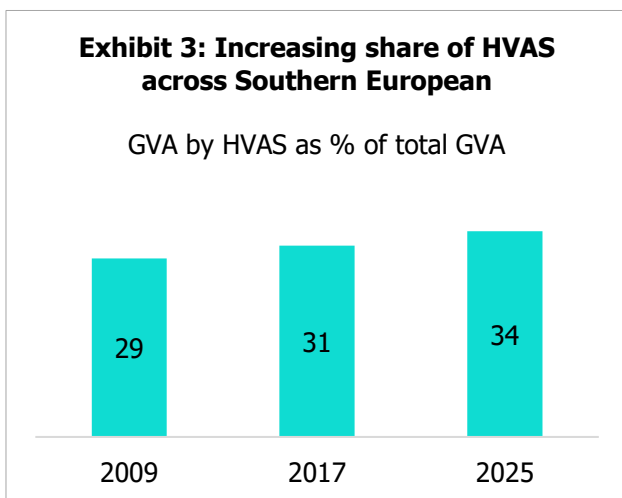
Sustained employment gains, supported by earlier reforms, lifted demand. Since the mid-2010s, unemployment rates have fallen sharply by 10-15 percentage points across Southern economies (Exhibit 2), lifting household incomes, and broadening the growth base relative to the previous decade.



Source: IMF WEO, CGIL

B. Gradual shift towards HVAS

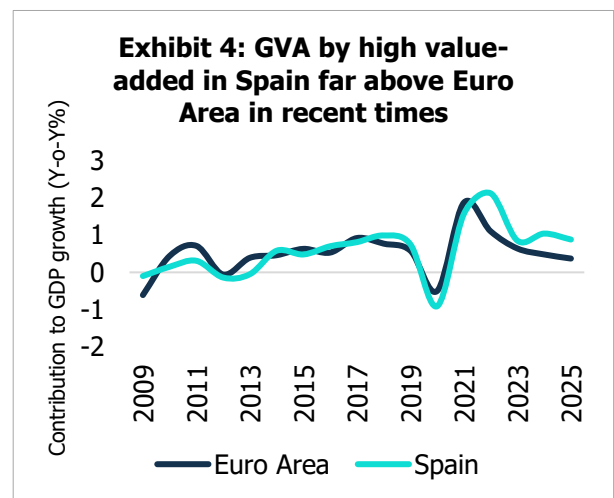
Notably, the quality of growth has also improved. While tourism remains a key driver, there has been a gradual diversification within services toward HVAS, such as ICT, professional and business services, financial services, and advanced transport and logistics. Across Southern Europe, HVAS now accounts for approximately 34% of gross value added (GVA) vs 29% in 2009 (Exhibit 3). This shift is particularly pronounced in Spain, where the expansion of high-productivity services has outpaced the Euro Area average. These sectors are more productive and less volatile, making growth more resilient (Exhibit 4).



Source: Eurostat, CGIL

Note: Southern Europe includes Cyprus, Greece, Italy, Portugal, and Spain

HVAS denotes high value-added services



Source: Eurostat, CGIL

C. Cyclical support from EU funding

Structural improvements have been reinforced by support from the EU, particularly through the RRF. These funds have supported investment and growth without materially weakening public debt dynamics, given their grant component and favourable financing terms.

Italy, Spain, and Portugal have led the way in deploying RRF funds, with 45-60% of their allocations committed or disbursed by 2024-25, well ahead of several European peers. This strong execution has generated a multiplier effect, stimulating domestic demand, accelerating public investment, and crowding in private capital.

D. Post-pandemic tourism boost

Tourism remains a key growth engine for Southern Europe, with post-pandemic performance now exceeding pre-Covid levels in scale as well as value. The sector’s contribution has been immense. For instance, tourism accounted for more than two-thirds of Spain’s GDP growth in 2023, while in Greece robust tourism export receipts offset nearly 70% of the goods trade deficit. In Greece, the sector also generates a strong multiplier effect, with every €1 of tourism revenue supporting €2.2-2.6 in overall economic output.

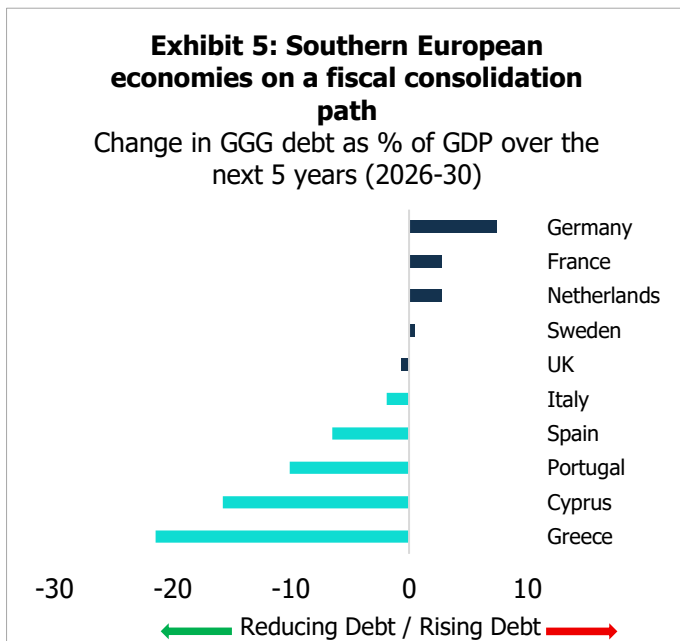
Beyond post-pandemic reopening, tourism is stronger because of improved internal competitiveness, better infrastructure, and a shift towards higher-spending visitors (more visitors from Germany, France, the US, and the UK than from lower income countries). This has made tourism a more resilient contributor to growth than in the past.

Fiscal outcomes and debt dynamics

Structural repair and temporary support have together led to a sustained fiscal turnaround. Most Southern European sovereigns have returned to primary surpluses, while favourable interest growth differentials have enabled active debt reduction cycles, even with higher rates. This is a clear contrast with the pre-2019 period, when growth upswings failed to translate into durable fiscal improvement.

Improved tax compliance, robust labour markets, and higher nominal growth have boosted government revenues. In some countries, tourism has also helped improve finances, despite persistent headline deficits.

Beyond headline consolidation, the composition of public debt has become more credit-supportive across Southern Europe. Average debt maturities have lengthened to over 7-8 years from 6 years since the mid-2010s, reducing rollover risk and near-term refinancing pressures. Parallely, debt is largely fixed rate, especially in Greece, Italy and Portugal, which slows the pass-through of higher interest rates to borrowing costs.



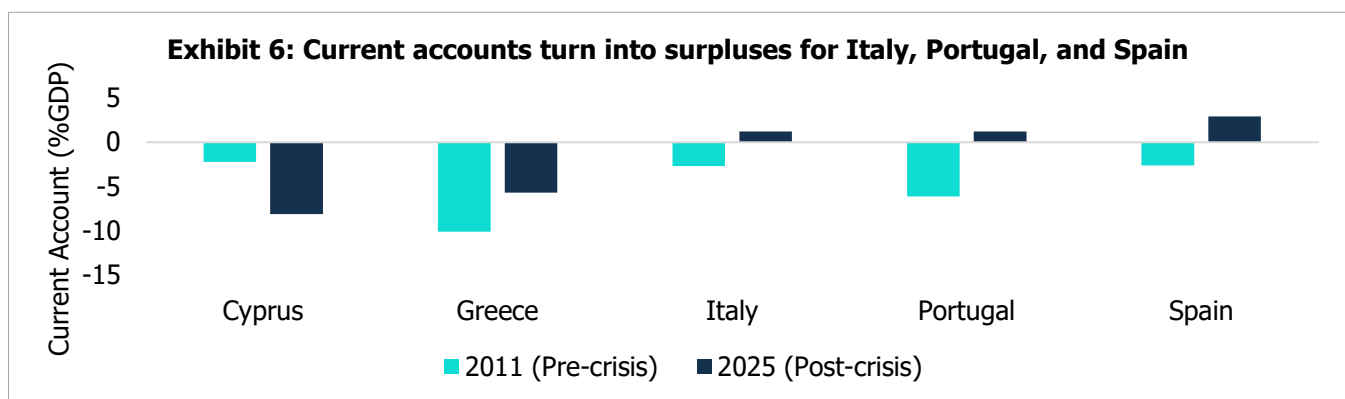
Source: IMF WEO, CGIL
 Note: The values used above for calculations are IMF projections, GGG = Gross General Government

That said, outcomes differ across countries (Exhibit 5).

- Cyprus and Portugal have led consolidation, supported by strong institutions, rapid nominal growth and effective use of EU funds, resulting in quickly falling debt ratios and clear fiscal improvement.
- Spain's progress has been slower; while revenues and growth have been strong, political fragmentation has constrained consolidation.
- Greece and Italy have the toughest task due to their high debt, but the nature of the challenge has shifted. Greece is now able to cut debt thanks to strong growth, primary surpluses, and a negative interest-growth gap.
- Italy's improvement is more fragile, as debt stabilisation is reliant on sustained growth and favourable financing conditions, making it more sensitive to policy slippage or shocks.

External rebalancing

Reforms have boosted competitiveness and improved current account positions. For instance, Spain and Portugal moved from large pre-crisis deficits to sustained surpluses of 2-3% of GDP (Exhibit 6). Italy's adjustment has been more gradual, moving from persistent deficits to a modest but durable surplus. Cyprus' widening of current account deficit largely reflects elevated profit repatriation by special purpose entities (SPEs). Thus, Southern Europe's recovery reflects both domestic and external balance-sheet repair.



Source: Havers Analytics, CGIL

West Asia crisis a manageable risk for Southern Europe

Southern Europe's exposure to the current West Asia crisis is expected to be lower than during the Russia-Ukraine shock, reflecting structural changes in energy dependence and economic composition. Services account for a large share of GDP (65-70%) across the region, limiting sensitivity to energy-intensive price shocks and supporting external balances.

Renewable energy now accounts for roughly 25% of final energy consumption across these economies, helping reduce energy import dependence and partly contain current account pressures, even during periods of global price volatility. Progress in energy transition has strengthened macroeconomic resilience and improved external stability.

The recent 40% rise in gas and oil prices following West Asia tensions is more moderate than the 2022 shock, when prices rose severalfold. Thus, the impact on inflation is expected to be smaller and the fiscal impact is likely to be manageable as there is limited need for support measures.

Greece and Cyprus are likely to be most exposed. About 36% of Greece's oil balance is linked to Gulf supply routes. Cyprus remains the most oil-dependent EU economy, with around 86% of its energy derived from oil and 88% from imports, amplifying current account sensitivity to sustained price increases.

Overall, the current conditions suggest that the West Asia crisis represents a manageable downside risk, unlikely to derail Southern Europe's improving growth, fiscal, and external metrics.

Credit fundamentals strengthen

According to CareEdge Global Ratings, Southern Europe's stronger fiscal and economic fundamentals support stable credit ratings and limit downside risks. A visible indicator of this improvement is the compression in sovereign spreads relative to Germany, signalling improved market confidence. Compared with crisis peaks in 2012-13, 10-year spreads narrowed materially in the early 2020s. Despite some volatility following ECB policy normalisation, they remain well below sovereign debt crisis levels.

The region has transitioned from fragile stabilisation to a durable consolidation phase, as reflected in improving debt trajectories and stronger fiscal performance. CareEdge Global Ratings had identified these improving fundamentals early on, reflecting in a stronger rating at the time of its initial sovereign assessment.

Looking ahead, while the momentum remains positive, high starting debt levels and adverse demographic dynamics may continue to constrain the rating upside. A positive rating action would depend on:

- Maintaining primary surpluses over the medium term
- Achieving stronger productivity growth
- Reducing reliance on EU funding and cyclical tailwinds
- Implementing credible measures to address demographic pressures

Overall, while the trajectory is positive, the durability of Southern Europe's recovery depends on its ability to sustain structural gains beyond the current favourable environment.

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