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Opinion of the European Economic and Social Committee on additional considerations on the Euro area economic policy 2023

(own-initiative opinion)

(C/2024/870)

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1. **Conclusions and recommendations**

1.1. The European Economic and Social Committee (EESC) recommends that ECB monetary policy remains constantly adapted to economic data in order to achieve the inflation target of 2 % in the medium term and on a solid basis, while managing the risk of overtightening. Overtightening will inevitably result in adverse consequences for both households and businesses, harming the sustainability of loans, reducing access to credit and hindering investments to combat climate change.

1.2. A prudential approach by the ECB is especially recommended in the current economic context, with reduced economic growth coupled with the risk of recession in several Member States. Projections regarding the best policy direction for the ECB are however very difficult, since it is becoming necessary to strike a balance between reducing persistent high inflation and avoiding an imminent recession, while substantial uncertainty in key policy areas remains high.

1.3. The EESC supports the Commission’s proposal for the euro area countries to coordinate their fiscal policy with the monetary policy of the ECB in order to achieve a monetary policy that is effectively able to tame inflation within a coherent approach.

1.4. With regard to energy, the EESC points out the residual uncertainty in terms of geopolitical and energy-supply related risks, with prices remaining historically high although appearing more balanced than in the past. The EU should therefore intensify its path towards a wider diversification of energy supply.

1.5. The EESC is concerned about high inflation, which is expected to be 5,6 % in 2023, and in particular about inflation in the food sector, where competition does not always seem vigorous in some Member States.

1.6. The EESC observes that the gradual phasing out of the temporary frameworks regarding State Aid, already planned by the Commission, should lead to more targeted measures with improved design, efficiency and affordability in order to preserve the consolidation of the internal market, given the different capacities among the Member States to grant State Aid.

1.7. The EESC notes ECOFIN’s *Recommendation on the Economic Policy of the Euro Area*, which states that, in the current context, ‘a broad-based fiscal expansion to support demand would likely further fuel inflationary pressure’. Fiscal policies should therefore be appropriately differentiated across the Member States, given the different situations of their public finances.

1.8. The EESC points out that targeted fiscal measures are needed to support vulnerable people and companies, especially from the perspective of maintaining jobs and human capital, while preserving price signals and providing incentives to reduce energy consumption. Sufficient levels of investment in research, development and innovation to increase productivity and drive the growth of the real economy, as well as to maintain competitiveness, should also be duly supported.

1.9. The EESC welcomes the Commission's legislative proposals to reform the EU's economic governance for the first time since the financial crises, observing that, for the reformed framework to be successful, ownership of the process by the Member States and the effectiveness of the new rules will be decisive.

1.10. The EESC welcomes the relative resilience of the labour market shown by the most recent data, even though youth unemployment is significant in several Member States and real wages are facing some serious pressure. As noted by the ECB, in the current tight labour market, nominal wages should rise in order for real wages to recover some of their purchasing power.

1.11. In view of the persistent inflation and its adverse effects on real wages, the EESC believes that the social partners and governments should negotiate and agree on national income pacts to reduce inflation without undermining investment and growth, and that these pacts should be accompanied by targeted measures to support vulnerable sections of the population

1.12. The EESC believes that the efficient implementation of the Recovery and Resilience Facility (RRF) will remain crucial in the remaining period, and calls for a thorough evaluation of the impact of the funded projects to ensure that they align with long-term goals and are actually able to contribute to recovery and resilience.

1.13. Furthermore, the EESC encourages both the ECB and national governments to roll out alternative support measures and appropriate initiatives, other than interest rates changes, to put inflation on a downward path as soon as possible, especially considering that some of the main drivers of inflation are significant distortions and disruptions on the supply side.

1.14. The EESC expresses its apprehension about the state of the euro-area economy after the September ECB interest rate increases, pointing out that, based on the current economic fundamentals, further increases should be avoided. The challenge now for all policy-makers becomes determining how soon it will be possible to put interest rates on a downward path.

2. **Context and background**

2.1. The European economy is growing moderately. Lower energy prices (except in the case of oil), abating supply chain constraints and a strong labour market have indeed supported moderate growth during the first quarter of 2023, avoiding a recession. However, the chances of recession seem to have increased, looking at the most recent economic data.

2.2. Based on the European Commission's Summer Economic Forecast, the growth outlook for the EU economy was revised down to 0,8 % in 2023 (1,0 % in the Spring Interim Forecast) and 1,4 % in 2024 (1,7 % in the spring). Downward trends are similar for the euro area, with GDP growth now expected respectively at 0,8 % and 1,3 % in 2023 and 2024.

2.3. Inflation is expected to continue to decline over the forecast horizon, with expected values of 5,6 % in 2023 and 2,9 % in 2024 across the euro area, requiring appropriate action by the ECB in terms of monetary policy. As inflation remains high — raising concerns especially with regard to the food sector where competition does not always seem vigorous in some Member States — financing conditions are set to tighten further. Moreover, even though the ECB and other central banks are expected to be approaching the end of the interest rate hiking cycle relatively soon, the recent turbulence within the financial sector in the US and Switzerland is likely to reverberate on both costs and the ease of accessing credit.

2.4. The adverse impact of Russia's war of aggression against Ukraine on energy bills across the EU has proved less disruptive than initially forecast, thanks to a mild winter coupled with a rapid diversification of energy supply and a sizeable fall in gas consumption, leading to lower prices.

2.5. As the Commission's Spring Economic Forecast previously pointed out, strong nominal growth and the unwinding of residual pandemic-related measures led the EU aggregate government deficit to fall to 3,4 % of GDP in 2022, although the phasing out of such programmes had a specific impact on the weaker sections of the population.

2.6. A dynamic labour market is contributing to the resilience of the EU economy, with EU unemployment setting a record low of 6,0 % in March 2023, supplemented by strong participation and employment rates. At the same time, however, shortages are persistent, especially with regard to highly skilled workers. Notwithstanding that, youth unemployment is still significant in several Member States and real wages are facing some serious pressure due to high inflation.

2.7. The EU labour market is expected to react only mildly to the slower pace of economic expansion. Employment growth is forecast at 0,5 % this year, before edging down to 0,4 % in 2024. The unemployment rate is projected to remain just above 6 %.

2.8. In its recent opinion [1], the EESC took a position on the economic policy to be implemented within the euro area. This opinion builds on the previous one, updating the EESC's position based on the latest developments and data.

3. **General and specific comments**

3.1. The EESC notes that, during its September meeting, the ECB raised the deposit interest rate by 25 basis points to 4 %, reaching the highest level ever. The ECB, which had already trimmed growth predictions for the next three years after its July meeting, warned that its Governing Council is determined to ensure that inflation returns to its 2 % medium-term target in a timely manner.

3.2. Since rates might be higher than expected for a longer period due to the persistency of inflation, the EESC recommends that monetary policy remain constantly adapted to economic data to achieve the ECB inflation target of 2 % on a solid basis while managing the risk of overtightening. Overtightening may indeed result in adverse consequences for both households and businesses, harming the sustainability of loans (more non-performing loans (NPLs)), reducing access to credit (especially for SMEs) and hindering investments to combat climate change.

3.3. A prudential approach is especially recommended in the current economic context, with reduced economic growth coupled with the risk of recession in several Member States. Having said that, projections regarding the best policy direction for the ECB are very difficult, since it is becoming necessary to strike a complicated balance between reducing persistent high inflation and avoiding an imminent recession, while substantial uncertainty in key policy areas remains high.

3.4. As stated in its previous opinion [2], the EESC supports the Commission's proposal for the euro area countries to coordinate their fiscal policy with the monetary policy of the ECB. Coordination in this regard is important in order to support a monetary policy that is effectively able to tame inflation within a coherent approach, especially considering that current inflation is, partially, due to significant distortions and disruptions on the supply side.

3.5. With regard to energy prices, the EESC underlines the residual uncertainty in terms of geopolitical and energy-supply related risks, with prices remaining historically elevated although appearing more balanced than in the past. The EU should therefore intensify its path towards a wider diversification of energy supply and reduced dependency on imported fossil fuels within the green transition process already undertaken.

3.6. The EESC observes that the Commission relaxed State Aid rules via the *Temporary Crisis and Transition Framework* in order to cope, inter alia, with price increases in the energy sector after the invasion of Ukraine. Such measures were able to duly support enterprises and especially SMEs in times of hardship. However, it is worth noting that the ability of Member States to grant State Aid varies significantly and has proved to be differentiated in recent years, with possible prejudice to the consolidation of the internal market, since some Member States have more financial resources and more capacity to deploy such resources than others. The gradual phasing out of the temporary framework, already planned by the Commission, should therefore lead to more targeted measures with improved design, efficiency and affordability.

(1) Opinion of the European Economic and Social Committee on 'Recommendation for a Council recommendation on the economic policy of the euro area' (COM(2022) 782 final) (OJ C 140, 21.4.2023, p. 58).
(2) Opinion of the European Economic and Social Committee on 'Recommendation for a Council recommendation on the economic policy of the euro area' (COM(2022) 782 final) (OJ C 140, 21.4.2023, p. 58).

3.7. The EESC notes ECOFIN's *Recommendation on the Economic Policy of the Euro Area* [3], which states that, in the current climate, 'a broad-based fiscal expansion to support demand would likely further fuel inflationary pressure'. Fiscal policies should therefore be appropriately differentiated across the Member States, given the different situations of their public finances. In this respect, responsible fiscal consolidation will support monetary policy, allowing the ECB to accelerate the process of lowering interest rates.

3.8. At the same time, targeted and temporary fiscal measures are needed to support vulnerable people and companies, especially from the perspective of maintaining jobs and human capital, while preserving price signals and providing incentives to reduce energy consumption. Suitable levels of investment in research, development and innovation to drive the growth of the real economy, increase productivity and maintain competitiveness should also be duly supported. Close coordination of policy responses between Member States is crucial in this respect.

3.9. The EESC welcomes the Commission's legislative proposals [4] to reform the EU's economic governance for the first time since the financial crises. The new rules aim to strengthen public debt sustainability, promoting sustainable and inclusive growth in all Member States through reforms and investments. The EESC observes that, for the reformed framework to be successful, ownership of the process and commitment by the Member States and the effectiveness of the new rules will be decisive.

3.10. The EESC acknowledges the Commission's plan to maintain reference values concerning deficit/GDP ratio at 3 % and debt/GDP ratio at 60 %, but stresses that fiscal structural plans need to ensure that debt-to-GDP ratios are put on a downward path or stay at prudent levels. The Commission's focus on net primary expenditure as the main evaluation parameter of the new economic governance is also supported [5]. At the same time, the EESC is concerned that public investment might be too restrained in the new framework. Therefore, the EESC calls for the possibility to prioritise public investments aimed at spurring on the green and digital transitions, as well as in the area of defence.

3.11. The EESC's position on the European Commission's proposal on economic governance is reflected in its dedicated opinion [6], which welcomes the establishment of differentiated national paths to ensure sustainable public finances through fiscal and structural plans based on compromises negotiated between European and national authorities. The EESC considers that national ownership of these commitments, as part of a more democratic understanding of EU economic governance, requires greater involvement of national parliaments and local and regional authorities, as well as the participation of the social partners and civil society organisations in formal consultation processes.

3.12. The EESC welcomes the relative resilience of the labour market shown by the most recent data, underlining at the same time its concern for the widespread difficulties businesses are facing in hiring skilled workers [7]. In this regard, the EESC stresses the critical importance of rapidly implementing the recommendations set out in the *Employment and Social Developments in Europe Report* on *Addressing labour shortages and skills gaps in the EU* [8].

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(3) 2023 recommendation on the economic policy of the euro area, 6.1.2023.

(4) New economic governance rules fit for the future.

(5) Opinion of the European Economic and Social Committee on the communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: Communication on orientations for a reform of the EU economic governance framework (COM(2022) 583 final) (OJ C 146, 27.4.2023, p. 53).

(6) Opinion of the European Economic and Social Committee on the proposal for a Regulation of the European Parliament and of the Council on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97 (COM(2023) 240 final — 2023/0138 (COD)), the proposal for a Council Regulation amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (COM(2023) 241 final — 2023/0137 (CNS)) and the proposal for a Council Directive amending Directive 2011/85/EU on requirements for budgetary frameworks of the Member States (COM(2023) 242 final — 2023/0136 (NLE)) (OJ C, C/2023/880, 8.12.2023, ELI: http://data.europa.eu/eli/C/2023/880/oj).

(7) Survey on the Access to Finance of Enterprises (SAFE).

(8) Commission report finds labour and skills shortages persist and looks at possible ways to tackle them.

3.13. In view of the persistent inflation and its adverse effects on real wages, the EESC believes that the social partners and governments should negotiate and agree on national income pacts to reduce inflation without undermining investment and growth, and that these pacts should be accompanied by targeted measures to support vulnerable sections of the population [9].

3.14. As previously noted [10], a swift implementation of the Minimum Wage Directive across Member States is strongly recommended to achieve a labour market able to be both strong and fair, preserving the purchasing power of wages during challenging times of high inflation. Effective, targeted actions by Member States in implementing the Directive become crucial in this respect and could lead to more convergence across the EU.

3.15. The EESC believes that the recent bank crisis in the USA and the case of Credit Suisse in Europe highlight the importance of speed in containing the risk of contagion and the loss of confidence by investors and depositors in case of bank crises. The need for flexibility in developing solutions on a case-by-case basis also emerged. The EESC, as pointed out in its previous opinion [11], therefore appreciates the Commission's recent comprehensive initiative to complete the bank crisis management and deposit insurance (CMDI) legal framework, as advancing the Banking Union is a key step to strengthen the European single market in the interests of taxpayers and businesses. However, some serious concerns stem from the lack of ECB supervision of significant parts of the EU banking system, which might at least partially be addressed by a swift approval and implementation of the CMDI legal framework.

3.16. The implementation of the RRF is well underway and it is crucial that Member States effectively utilise the available funds to improve their economies for future challenges. The implementation of the Recovery and Resilience Facility (RRF) is crucial for the remaining period, and a thorough evaluation of the impact of the funded projects will be required to ensure that they align with long-term goals and are actually able to contribute to recovery and resilience.

3.17. The EESC welcomes the ECB and the Commission's joint effort towards the digital euro, which brought about the publication of the digital euro package on 28 June 2023 [12]. An ambitious and challenging goal such as the digital euro could enable the modernisation of the common currency in line with technological developments, bringing potential benefits to citizens and businesses across the EU.

3.18. The European economy is facing many challenges related to the current global economic slowdown, high public debt levels in some countries, high inflation, and climate change. In this context, the EESC points out that coordinated efforts by all decision-makers and the involvement of relevant stakeholders in the decision-making process regarding economic policies is needed.

4. **Latest developments**

4.1. On 14 September, the ECB increased for the tenth time its reference interest rates by 25 points, with its main deposit rate reaching 4 %, the highest ever in its history. The ECB also hinted that this increase might be the last. The EESC expresses its apprehension about the state of the euro-area economy, as this latest increase, coupled with the previous ones, is already harming and will further harm the weak prospects of growth in the euro area, possibly triggering stagflation in the worst-case scenario.

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(9) Opinion of the European Economic and Social Committee on additional considerations on the Annual Sustainable Growth Survey 2023 (OJ C, C/2024/871, 6.2.2024, ELI: http://data.europa.eu/eli/C/2024/871/oj).

(10) Opinion of the European Economic and Social Committee on 'Recommendation for a Council recommendation on the economic policy of the euro area' (COM(2022) 782 final) (OJ C 140, 21.4.2023, p. 58).

(11) Opinion of the European Economic and Social Committee on the Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on the review of the crisis management and deposit insurance framework contributing to completing the Banking Union (COM(2023) 225 final) — on the Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 as regards early intervention measures, conditions for resolution and funding of resolution action (COM(2023) 226 final — 2023/0111 (COD)) — on the Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/59/EU as regards early intervention measures, conditions for resolution and financing of resolution action (COM(2023) 227 final — 2023/0112 (COD)) — on the Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/59/EU and Regulation (EU) No 806/2014 as regards certain aspects of the minimum requirement for own funds and eligible liabilities (COM(2023) 229 final — 2023/0113 (COD)) (OJ C 349, 29.9.2023, p. 161).

(12) Opinion of the European Economic and Social Committee on 'A digital euro and the scope and effects of the legal tender status of banknotes and coins' (OJ C, C/2023/860, 8.12.2023, ELI: http://data.europa.eu/eli/C/2023/860/oj).

4.2. The EESC worryingly notes that ten consecutive rate increases have already caused recession in some Member States and may rapidly push more Member States and even the whole euro area into recession.

4.3. The EESC hopes that the indication by the ECB president that interest rates might have reached their peak will prove correct. On the other hand, it expresses its concern, given that interest rates may remain high for a long period of time in order to successfully combat inflation. The real challenge now for all policy-makers is determining how soon it will be possible to put interest rates on a downward path to avoid exacerbating the current pressures on the economy.

4.4. The EESC acknowledges that inflation prospects remain high and need to be tackled as soon as possible before finally being able to reduce rates in the short term to preserve both businesses and households. Furthermore, it encourages both the ECB and national governments to roll out alternative support measures and appropriate initiatives, other than interest rates changes, to put inflation on a downward path in the near future, especially considering that some of the main drivers of inflation are significant rigidities, distortions and disruptions on the supply side.

4.5. Finally, the EESC expresses its concern about the state of the euro-area economy after the September ECB interest rate increases, pointing out that, based on the current economic fundamentals, further increases should be avoided.

Brussels, 25 October 2023.

The President
of the European Economic and Social Committee

Oliver RÖPKE