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NOTE

from:	GENERAL SECRETARIAT OF THE COUNCIL
to:	COREPER/COUNCIL
Subject:	Draft Council Conclusions on a coordinated EU response to the economic slowdown

Delegations will find attached draft Council Conclusions on a coordinated EU response to the economic slowdown, following discussions in the Economic Financial Committee.

The text includes the messages agreed by Finance Ministers at their informal meeting in Nice, as well as elements relating to the Commission communication and report on EMU@10.

Encl.:

A coordinated EU response to the economic slowdown

During the last quarters, the EU economy has been hit by several major shocks, including financial market turmoil and the rise in commodity prices, which imply a transfer of wealth to producing countries, even if the recent weeks have shown some improvement on the latter front.

The economic slowdown in the EU during the second quarter of 2008 has been more abrupt than envisaged a few months ago. At the same time, as a result of the rise in energy and food prices, inflation has been dynamic.

Even if European economies are better equipped to face this slowdown than in the past, thanks to the reforms carried out in recent years, near term outlook for growth remains relatively weak, whereas the recent decrease in oil and food prices, which had largely contributed to feeding inflation, and the economic slowdown, should contribute to alleviate inflationary pressures in the next few months.

To a large extent Member states are facing common shocks. The economic situation calls for a coordinated response at the EU level, based on a common understanding of the problems at hand, with some common features and also national specificities – taking into account the fact that there is some variation in initial situations as well as in the manner the shocks are transmitting across Member states' economies.

A strategy for EU member states could build on the following elements:

a) At the macroeconomic and structural level, ensure domestic policies are in place to support growth in a sustainable manner…

European macroeconomic policies need to respond in an appropriate and consistent way to the shocks stemming from the global economy. These shocks are to a large extent faced by all Member states, even though the precise effect on the economies may differ across economies -notably in view of the importance of the financial shock and housing market evolutions – and across groups - measures have often been taken to support the most vulnerable.

At the current juncture, designing policies which help curb the inflation, thereby improving purchasing power of people, fostering sustainable growth and help restoring an environment supportive to monetary policy, is key.

Ministers are fully committed to implement policies that are in line with this objective:

- structural reforms should be pursued vigorously since they can strengthen the resilience and adjustment capacity of the economy and, by increasing growth potential, allow the economy to fully benefit from the future upswing while helping absorb the shocks in the short run through increased flexibility. In particular, reforms such as enhanced competition in product and service markets - notably in retail services - should help reduce inflationary pressures, thereby supporting the purchasing power. Also, improved labour market flexibility and mobility can contribute to a quicker adjustment of the economy. Member states should set out ambitious National reform programmes this autumn and firmly implement them.

- wages should be supportive of employment and competitiveness. Dialogue with social partners will be pursued by Ministers this autumn.

- fiscal prudence is necessary to support confidence notably in view of the ageing of the population and to ensure a good mix between fiscal and monetary policy. The 2005 reformed Stability and growth Pact is the adequate framework and should be fully applied. It contains flexibility to allow for fiscal policy to play its normal stabilisation function. In particular, relatively large European automatic stabilisers can help cushion the slowdown, while respecting the 3% of GDP deficit threshold. In countries facing more severe slowdown and where room for manoeuvre exists, temporary and targeted measures may be taken, notably towards those most affected by the current economic situation. They would also have to take into account the specific challenges of the country concerned, i.a. the need to recover competitiveness.

More broadly, Ministers agree that during the last ten years, the Economic and Monetary Union (EMU) has contributed to macroeconomic stability and that now more than ever, it is proving to be a major asset. Europe is not insulated from developments in the global economy but, also thanks to the reform process, it is better equipped to cope with the current shocks than in the past. Nevertheless, within the existing framework, there is potential to reap further benefits from EMU and to improve the performance of EU Member states.

- In order to ensure a prudent fiscal stance throughout the cycle, recent experience suggests that work is needed to better take into account the effects of economic cycles, and of the related cycles in asset prices, on tax revenues.

- Also, coordination should be broadened to macroeconomic developments beyond fiscal policy. In particular, in light of the recent experience, which shows the importance to avoid building up imbalances, Ministers agree that competitiveness developments should be better monitored, notably within the euro area and for ERM II countries.

- Finally, structural reforms are key to all Member states. Recommendations made in this respect should be prioritized to fully take into account the economic situation. As structural reforms have an added value for the euro area as a whole, Ministers from the euro area also agree to devote specific attention to euro area recommendations.

b) Restore confidence on financial markets and avoid excessive tightening of credit toward SMEs in the EU

The financial turmoil is a key component of the current global economic slowdown. The key response in the short term remains restoring confidence in the financial system through a full implementation of the Ecofin roadmap. In this respect, financial institutions are continuously making efforts to improve disclosure of their exposure to risks; but those efforts still need to be properly assessed by banking supervisors within CEBS. By the end of the year, we also expect proposals for a revision of the prudential framework for securitisation under the CRD, which will help to restore confidence in this activity.

On asset valuation, revised standards are urgently awaited from the International Accounting Standards Board; otherwise, persistent concern about the accounting treatment of assets will continue to undermine investor confidence.

In the current macroeconomic and financial market situation, it is also important to monitor and remedy potential procyclical effects. In prudential matters, Basel II remains a relevant framework to improve risk management. In implementing the new framework, banking supervisors will monitor the potential procyclical effects of the new regulation and assess whether remedial measures are needed.

Also, in order to improve the accessibility and availability of finance for SMEs, the EIB group will adopt a series of reforms to strengthen its SME finance products as well as offer a substantial development of its global loans to its banking partners, both in quantitative and qualitative terms, ensuring that the benefit reaches the SMEs, thereby also contributing to the “Small Business Act” initiative.

The EIB is proposing to raise its level of lending to SMEs to up to 15bn euros (+50%) in 2008/2009, including with a new product line allowing risk sharing with banks.

Ministers ask the European Investment Bank and the Commission to set up a working group, also consulting with European institutional investors, with the task of reporting on further coordinated response with a specific focus on energy programmes and infrastructures.

c) On the external front, contribute to a more favourable environment

Excessive volatility on exchange rate markets is undesirable for economic growth. The recent re-appreciation of the US dollar vis-à-vis the euro and other European currencies is welcome.

In some emerging economies with large and growing current account surpluses, it is crucial that exchange rate moves so that necessary adjustment will occur. These developments must be seen in their multilateral context. The EU will continue to monitor them closely, including through the consultation with China planned by euro area authorities.

In response to the current global crisis in the financial sector, Europe should continue to act proactively in international fora, notably at the FSF and the IMF. Also, Ministers agree to increase the political impetus to the economic and financial dimension of the Union's relations with European Union partners, notably at the occasion of bilateral Summits.