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#### COVER NOTE

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From: Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director

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To: Ms Thérèse BLANCHET, Secretary-General of the Council of the European Union

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Delegations will find attached document COM(2023) 903 final.

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Strasbourg, 21.11.2023  
COM(2023) 903 final

Recommendation for a  
**COUNCIL RECOMMENDATION**  
**on the economic policy of the euro area**  
{SWD(2023) 903 final}

Recommendation for a

## **COUNCIL RECOMMENDATION**

### **on the economic policy of the euro area**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 136 in conjunction with Article 121(2) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies<sup>1</sup>, and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances<sup>2</sup>, and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) The euro area economy has shown resilience in the face of the major economic shocks of recent years, but it has recently lost momentum. After the sizeable recovery in 2021 and 2022, growth in the euro area is expected to slow down to 0.6% in 2023. High and still fast increasing consumer prices for most goods and services have been taking a heavy toll, despite declining energy prices, and external demand is not providing strong support. Meanwhile, the response of monetary policy to high inflation is working its way through the economy. On the positive side, the labour market remains strong, with the unemployment rate at a record low, with differences across Member States and regions, and participation and employment rates at record high, though signs of cooling are emerging. In 2024, a gradual recovery in growth is expected, by 1.2%, on the back of continued expansion of employment and rising real wages, while disinflation continues. The outlook remains surrounded by high uncertainty and risks, primarily related to the evolution of Russia's ongoing war of aggression against Ukraine and the situation in the Middle East following the brutal terrorist attacks on Israel by Hamas, which may impact energy markets. Furthermore, the impact of policies to fight against inflation and their possible effects on economic activity add to the risks surrounding the outlook. Structural changes linked in particular to the intensifying impact of climate change, as illustrated by the extreme weather conditions and unprecedented wildfires and floods in the summer, also weigh on the outlook.

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1, ELI: <http://data.europa.eu/eli/reg/1997/1466/oj>.

<sup>2</sup> OJ L 306, 23.11.2011, p. 25, ELI: <http://data.europa.eu/eli/reg/2011/1176/oj>

- (2) Following the peak that occurred in October 2022, headline inflation in the euro area has eased, mainly driven by declining energy prices, but also by a gradual broad-based moderation in the other components. Yet, food and services inflation remain high, especially for the most vulnerable, and inflationary pressure remain substantial in a number of Member States. Inflation is set to decline to 5.6% in 2023 and further down to 3.2% in 2024, thus remaining above the ECB's 2% target. The disinflation process is aided by the ECB's fastest and largest interest rate increase since the creation of the monetary union. Sovereign yields in the euro area have increased but spreads have remained relatively stable. The ECB has repeatedly expressed its commitment to keep interest rates high for as long as necessary to bring inflation down to target and clarified that the future monetary policy path will continue to follow a data-dependent approach.
- (3) The energy price shock has dented cost competitiveness in the euro area, in particular for the more energy-intensive Member States and industries. So far, the negative impact of higher costs has been mitigated by exchange rate movements and by temporary measures taken by governments to support businesses and vulnerable households. However, the high cost of energy, together with differences in energy intensity of Member States' economies and in their energy sourcing, have contributed to large inflation differentials within the euro area. Despite the decrease in energy prices in 2023, these differentials have only partly subsided so far. Together with the dispersion in wages growth over the past two years, durable price differentials could result in durable competitiveness gaps across euro area Member States and contribute to macroeconomic imbalances that could undermine the functioning of the euro area. In the medium-term, the ability of the euro area and of Member States to strengthen productivity relies, in part, on the capacity to sustain innovation and investment. In that respect, prospects of energy prices and costs that could be permanently higher than those of trading partners, a persistent gap in productivity growth compared to peers, and rising risks of geoeconomic fragmentation would put the euro area economies at a disadvantage.
- (4) The current macroeconomic environment characterised by persisting uncertainty, high inflation, and compromised competitiveness of the euro area, calls for an ambitious policy agenda. In the short-term, ensuring the return of inflation to the ECB's 2% target remains a priority. In addition, persistent difference in inflation rates between Member States could translate into competitiveness divergences. Fiscal policy should contribute to disinflation, being differentiated according to country-specific levels of debt and inflation. Real income decreased in 2022, calling for wage developments to mitigate the loss in purchasing power, in particular for low earners. At the same time, second-round effects on inflation and competitiveness should be closely monitored by public authorities and taken into account in wage formation. In addition, limiting risks to macro-financial stability and the macroeconomic impact of tighter financial conditions remains crucial. Going forward, the euro area must continue fostering inclusive growth and preserve its global competitiveness, while avoiding divergences across the euro area. In this respect, reform and investments, including to foster the green and digital transition and the euro area's resilience, are instrumental. The timely and effective involvement of social partners, and strong social dialogue are key to support policy design and a broad ownership that fosters implementation.
- (5) After a sizeable crisis-related expansion in 2020 to 2022, the fiscal stance in the euro area is expected to be restrictive in 2023 and 2024, which is consistent with the need

to reduce public deficit and debt and to avoid fuelling inflationary pressures, while remaining agile in view of the high uncertainty. Between 2020 and 2022, the expansionary euro area fiscal stance, amounting to around 4% of GDP, supported the economy in the face of the COVID-19 crisis and the energy price boom following the Russian aggression of Ukraine. In 2023 and 2024, the aggregate fiscal stance is expected to turn contractionary, by ½% of GDP in both years, primarily due to the near complete phase out of crisis-related energy measures. The contractionary fiscal stance expected in 2023 and 2024 will contribute to restoring fiscal buffers over time and thus to improving the sustainability of public debt in some Member States. While ensuring compliance with the limits to net expenditure growth recommended by the Council, it is also important that the fiscal stance is modulated so to avoid lasting divergences in inflation. Besides the need to maintain a prudent fiscal strategy, public investment needs to be maintained and, where needed increased, to support long-term growth and the green and digital transition. In 2023 and 2024, public investment is expected to further expand in most Member States, with continuing support of the RRF and other EU funds. Public finances also face pressure arising from high costs related to ageing, defence, as well as the less favourable interest-growth differential. As part of the country specific recommendations, a number of euro area Member States were recommended to take measures to improve the sustainability of their pension and healthcare systems and to adopt tax reforms. Conducting spending reviews as a regular part of (multi)annual budgetary process would help improve the efficiency and quality of public expenditures. Such reviews need to have a clear scope, mandate and methodology and their outcomes should be communicated clearly to the public.

- (6) The aggregate debt-to-GDP ratio of the euro area is expected to decline by a cumulated 2.8 percentage points over 2023-2024, reaching 89.7 % of GDP by end-2024. The decline is mainly driven by nominal GDP growth which outpaces the average interest rate paid on outstanding debt. However, debt remains elevated in several Member States and the higher interest rates will gradually feed into the higher debt servicing costs, putting a strain on debt dynamics in the medium term to a varying extent depending on the level of debt, its maturity structure and the share of inflation-linked bonds. The Commission's proposal for a reform of the Economic Governance Framework<sup>3</sup> aims to promote realistic, sustained and gradual fiscal adjustments guided by country-specific medium-term plans and to enhance sustainable growth by incentivising relevant reforms and investments. The Council is resolved to conclude the work on the economic governance framework in 2023. Rapidly reaching an agreement on the revised legal framework will create clarity and predictability for fiscal policy going forward, promoting debt sustainability and economic growth at the same time.
- (7) The cost of emergency support measures taken to mitigate the economic and social impact of the rise in energy prices increased in 2023 in spite of the fall in energy prices from their 2022 peak. The Commission estimates that the net budgetary cost of such measures amounts to 1.0% of euro area GDP in 2023, down from 1.3% in 2022. In spite of previous policy advice and Member States' commitments to improve the quality of such support measures, almost half of the related budgetary cost in 2023 has gone towards price measures that are not targeted to vulnerable people and companies. Most of the measures are now expected to be phased out over

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<sup>3</sup> COM(2023) 240 final, COM(2023) 241 final and COM(2023) 242 final.

the course of 2024, in line with the expected stabilisation in energy prices; if these plans materialise there will be a residual budgetary cost of around 0.2% of GDP in 2024 for the euro area as a whole. However, should energy price increase again to levels that would necessitate new or continued support measures, these measures should be targeted at protecting vulnerable households and firms, fiscally affordable and preserve incentives for energy savings. More generally, and beyond crisis-related energy measures, stronger use of environmental taxation, in line with the polluter pays principle, together with phasing out of fossil fuel subsidies and other environmentally harmful subsidies could contribute to increase the fiscal space for euro area Member States.

- (8) Sustaining a sufficiently high level of high-quality public investment can help boost potential growth and support the green and digital transitions. In this respect, a full implementation of the reforms and investments under the Recovery and Resilience Facility (RRF) and of the cohesion policy funds is a priority. The implementation of national recovery and resilience plans is well under way, but progress varies across Member States and implementation needs to be stepped up in some instances to bridge accumulated delays. As of mid-November, the Commission has received 34 payment requests from 19 euro area Member States and disbursed a total amount of EUR 162.1 billion in grants and loans. This breaks down in EUR 51.6 billion paid in pre-financing and EUR 110.5 billion disbursed after milestones and targets were reached. The pace of disbursement in 2023 has been somewhat lower than expected, partly because Member States are focussing on revising their recovery and resilience plans due to changes in the grant allocation, new loan requests and the introduction of REPowerEU chapters<sup>4</sup>. Since the beginning of the COVID-19 pandemic, cohesion policy, under the European Regional Development Fund, Cohesion Fund, European Social Fund and the Youth Employment Initiative, has disbursed close to EUR 120 billion to euro area Member States. In the context of the Cohesion Policy mid-term review, Member States will have the opportunity to review Cohesion policy programmes and allocate funds to address pressing needs and emerging challenges. The 2024 European Semester cycle will provide orientations for the mid-term review and help direct additional funding in light of the socio-economic context and challenges in the Member States and the regions, while promoting complementarity with the Recovery and Resilience Facility and other EU funds.
- (9) Promoting private investment, innovation and skill development is key to enhancing productivity and strengthening the euro area competitiveness, in particular in support of the green and digital transitions. Removing barriers to investment, including through reforms that streamline and digitalise planning, permitting and other administrative procedures would help boost private investment. Industrial policy can also contribute by supporting investment, safeguarding competitiveness, and avoiding risks linked to excessive reliance on a limited number of third countries for key technologies, raw materials and industrial inputs. As part of its Green Deal Industrial Plan, the European Commission has put forward several initiatives to strengthen strategic sectors, including the Net-Zero Industry Act<sup>5</sup>, the Critical Raw

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<sup>4</sup> Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17), ELI: <http://data.europa.eu/eli/reg/2021/241/oj>

<sup>5</sup> COM(2023) 161 final

Material Act<sup>6</sup> and the Strategic Technologies for Europe Platform (STEP)<sup>7</sup>. The Innovation Fund and the Modernisation Fund also provide financial support for the necessary transition in the private sector. In addition, through the adoption of the Temporary Crisis and Transition Framework<sup>8</sup>, the European Commission has enabled Member States to use the flexibility foreseen under State aid rules to support measures in sectors which are key for the transition to a climate neutral economy. While euro area Member States have taken measures to support sectors most exposed to the energy crisis and to support the green transition, such measures are generally decided at country level, entailing a risk of distortion of the level playing field in the Single Market. STEP is a first step towards addressing the heightened need for EU public investments in such critical technologies, to leverage much greater private investments and can help safeguard cohesion and the Single Market. It is also an important element for testing the feasibility and preparation of new interventions as a step towards a European Sovereignty Fund. Strong capital markets are crucial for an inclusive, competitive, and resilient euro area economy. A deeper Capital Markets Union would help mobilise the required private financing for the green and digital transitions, reduce fragmentation and improve access to finance. In February 2023, the European Council called on the Council of the EU and the European Parliament to speed up the implementation of the Capital Markets Union Action Plan by advancing and finalising work on the legislative proposals in this area. In May 2023 the Eurogroup has set the aim to reach an agreement by March 2024 on areas that the European Commission should consider to further deepen the Capital Markets Union. As part of the work on the Economic and Monetary Union, the Commission tabled a proposal in 2023 on a legal framework for a digital euro. A digital euro, which would complement euro cash, would support the digitalisation of the economy as well as innovation in retail payments while reducing payments fragmentation across the Union. If issued, the digital euro would introduce a new possibility for using risk-free central bank money in European payment services. It would also facilitate cross-border payments and contribute to strengthening the international role of the euro as well as Europe's open strategic autonomy.

- (10) Despite a decelerating growth impetus, the labour market remains resilient. Employment continued to grow in 2023, together with working hours, against the backdrop of labour and skill shortages as well as an increased tendency of labour hoarding by companies. Although the overall good performance has been broad-based across Member States, some groups continue to be under-represented in the labour market (women, youth, low-skilled, persons with disabilities). Active labour market policies (together with the provision of quality and affordable early childhood education and care) play a key role in boosting participation and supporting skills provisions and acquisition, with a positive impact on potential output growth and competitiveness in the long-term. Complementing the harnessing of talents within the Union, managed legal migration from third countries, ensuring the respect and enforcement of labour and social rights, can help address skills and labour shortages. Euro area Member States issued 664 000 first work permits to third countries nationals for employment purposes in 2022, a number that has almost tripled in the 10 years.

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<sup>6</sup> COM(2023) 160 final

<sup>7</sup> COM(2023) 335 final

<sup>8</sup> OJ C 101, 17.3.2023, p. 3–46,

- (11) Nominal wages increased in 2022 (+4.8%) and during the first months of 2023, on the back of high inflation and tight labour markets. While this has partially mitigated losses in purchasing power, nominal wage growth has not kept up with inflation (-3.7% for real wages in 2022). Nominal wage growth is likely to be strong over 2023 and 2024, while real wages are set to increase moderately, strengthening domestic demand. At the same time, the expected growth in wages may affect prices of goods with a strong domestic labour component, such as services, although the impact on prices could be cushioned if past increases in unit profits are unwound. Higher wages could also affect competitiveness and durable divergences across the euro area may, among other factors, lead to macroeconomic imbalances. Wage agreements should therefore appropriately reflect euro area developments in addition to with national dynamics.
- (12) The rise in the cost of living, mainly related to the energy crisis and the associated worsening in the terms of trade, has had a negative impact on real income as well as significant social implications. In 2022, prices grew by 17.5% for housing, water, electricity, gas and other fuels, by 10.5% for food and non-alcoholic beverages and by 11.2% for transport. Low-income households suffered from particularly large cost-of-living adjustments. Over half of euro area Member States witnessed increases in material and social deprivation as well as in energy poverty, in spite of nominal wage developments and support mechanisms. In several Member States, increases in the cost of living disproportionately affected older people and people living in rural areas.
- (13) The euro area banking sector has proven to be resilient despite various episodes of heightened market turmoil. The euro area banking sector is now well capitalised and profitable, as confirmed by the EU-wide 2023 stress tests performed by the European Banking Authority. Alongside monetary and lending standards tightening, credit flows to the private sector are slowing down markedly. Going forward, a sharp deterioration in the macroeconomic outlook, together with interest rates staying high for an extended period of time, may translate into weaker asset quality. At the same time, the non-bank financial intermediation sector may be confronted with vulnerabilities. In a context of tighter financing conditions, monitoring risks in a timely manner, proactively engaging with debtors and actively managing non-performing loans will be important to maintain the financial sector's ability to finance the economy. Other risks to financial markets may emerge. In particular, higher risk premia amid tightening liquidity conditions may lead to a stronger and potentially disorderly correction in asset prices. The ongoing adjustment in the residential and commercial real estate markets also needs to be closely monitored. Rising mortgage rates and worsening debt-servicing capacity may lead to substantial corrections in house prices and could spur financial instability.
- (14) The Euro Summit statement of March 2023 reiterated the commitments of euro area Leaders to complete the Banking Union. In particular, the ratification of the revised European Stability Mechanism Treaty, allowing for the introduction of the common backstop to the Single Resolution Fund would further strengthen the euro area's resilience. Against this background, in April 2023, the Commission has tabled a proposal on the reform of the bank crisis management and deposit insurance framework, with the aim of enabling authorities to organise an orderly market exit for failing banks of any size and business models, including smaller players.



RECOMMENDS that euro area Member States take action, individually, including through the implementation of their Recovery and Resilience Plans, and collectively within the Eurogroup, in the period 2024 –2025 to:

1. Adopt coordinated and prudent fiscal policies to keep debt at prudent levels or put debt ratios on a plausibly downward path. Achieve an overall restrictive fiscal stance in the euro area and thus facilitate the timely return of inflation to the 2% target, while remaining agile in view of the high uncertainty. Wind down crisis-related energy support measures as soon as possible and use the resulting savings to reduce deficits. While ensuring compliance with the expenditure maxima recommended by the Council, modulate the fiscal stance to avoid lasting divergences in inflation. In the medium term, develop fiscal strategies to achieve a prudent medium-term fiscal position and strengthen debt sustainability where necessary, through gradual and sustainable consolidation, combined with high-quality public investments and reforms. Where needed, include in these strategies measures to further increase the efficiency and quality of public expenditures and to improve the sustainability and adequacy of the pension and healthcare systems.
2. Sustain a high level of public investment, to support the green and digital transition, strengthen productivity and resilience. Accelerate the implementation of the Recovery and Resilience Plans, including their REPowerEU chapters. Make full use of cohesion policy programmes and ensure that their mid-term review takes into account, among others, the challenges identified in the European Semester and the progress in implementing the European Pillar of Social Rights, without reducing their overall ambition.
3. In accordance with national practices and respecting the role of social partners, support wage developments that mitigate purchasing power losses, especially for low-income earners, taking due account of competitiveness dynamics and avoiding lasting divergences within the euro area. Promote upskilling and reskilling as well as active labour market policies to address labour and skill shortages and increase productivity. Take measures to facilitate managed legal migration of third countries workers in shortage occupations, in full complementarity to harnessing talents from within the EU. Safeguard and strengthen adequate and sustainable social protection and inclusion systems. Ensure the effective involvement of social partners in policymaking and strengthen social dialogue.
4. Remove investment obstacles to reduce the prevailing gap in investment for the green and digital transitions. Improve access to finance, in particular for innovative companies and SMEs, through further progress towards the Capital Markets Union. Ensure that public support to relevant strategic sectors is targeted, with no distortions of the level playing field in the Single Market and with a view to enhancing the euro area competitiveness and open strategic autonomy. Continue strengthening the international role of the euro and make further progress in the work on the digital euro.

5. Monitor risks linked to tighter financial conditions, in particular those related to the asset quality and to potential corrections in asset prices, including in real estate markets. Monitor developments in the non-bank financial intermediation to prevent the build-up of systemic risk and negative spillovers to the economy. Complete the Banking Union by continuing to work on all elements, including on a European Deposit Insurance Scheme.

Done at Strasbourg,

*For the Council*  
*The President*