Council of the European Union

Brussels, 19 December 2024
(OR. en)

17075/24

ECOFIN 1531
UEM 491
SOC 928
EMPL 625
COMPET 1228
ENV 1243
EDUC 458
RECH 549
ENER 613
JAI 1892
GENDER 261
ANTIDISCRIM 177
JEUN 292
SAN 727

COVER NOTE

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
date of receipt:	18 December 2024
To:	Ms Thérèse BLANCHET, Secretary-General of the Council of the European Union
No. Cion doc.:	COM(2024) 704 final
Subject:	Recommendation for a COUNCIL RECOMMENDATION on the economic policy of the euro area

Delegations will find attached document COM(2024) 704 final.

Encl.: COM(2024) 704 final

EUROPEAN
COMMISSION

Strasbourg, 17.12.2024
COM(2024) 704 final

Recommendation for a

COUNCIL RECOMMENDATION

on the economic policy of the euro area

{SWD(2024) 704 final}

EN EN

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 Regulation (EU) 2024/1263 of the European Parliament and the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97[1], and in particular Article 3(3)(a) 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[2], 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) On 4 November 2024, the Eurogroup issued a statement emphasizing the need for urgent action to address the Union's lagging productivity, innovation, and competitiveness through ambitious investment and structural reforms. This call to action was subsequently reinforced by the European Council, which issued a declaration on 8 November. The Eurogroup statement and the European Council declaration reflect the broad conclusions of the Draghi and Letta reports[3][4] and demonstrate a shared understanding of the challenges and opportunities the Union's economy is facing. They provide the context for the implementation of the new Economic Governance Framework ('the framework'), which entered into force on 30 April 2024. The framework aims at ensuring public debt sustainability and promote sustainable and inclusive growth through reforms and priority investments. The medium-term plans submitted by Member States to date put the emphasis on reforms and investments aimed at improving competitiveness. The framework acknowledges the role of the Council recommendation on the economic policy of the euro area, as part of the European Semester for economic policy coordination, to provide an assessment of macroeconomic policy for the euro area, including both on fiscal and non-fiscal aspects. By highlighting key macro-structural as well as institutional

[1] OJ L 1263, 30.4.2024, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.
[3] 'Much more than a market,' April 2024 (Letta Report).
[4] 'The Future of European Competitiveness, Part A and B,' September 2024 (Draghi Report).

challenges, priorities and recommendations collectively addressed to the euro area as a whole and its Member States, this Recommendation provides a platform for policy discussion on areas of common interest of the euro area Member States.

(2) The euro area has displayed remarkable macroeconomic resilience weathering rapid disinflation with minimal impact on employment. The euro area's ability to absorb shocks and rebound, as seen in its response to the COVID-19 and the energy crisis, has also contributed to this positive outcome. This resilience is largely due to the timely policy response by the Union, including by the European Central Bank (ECB), and the Member States, which helped to cushion the economy in the face of major crises. In that respect, the sound fiscal situation in several Member States in 2019, the swift activation of the general escape clause of the Stability and Growth Pact, and new Union instruments such as NextGenerationEU and SURE_alongside the Multiannual Financial Framework ('MFF') provided the euro area with crucial fiscal space, allowing an effective fiscal response. The structural transformation of the euro area over the last decade also enhanced its resilience. Labour markets have become more flexible, and financial systems demonstrated far greater robustness than during the Global Financial Crisis. In the post COVID-19 period, private consumption has benefitted from the strong labour market and policy-response driven transfers, though the savings rate has remained high. Public investment has been bolstered by the Recovery and Resilience Facility ('RRF') and other Union funds. Private investment has been much less dynamic, especially since 2022 in a context of tightening financial conditions and widespread global macroeconomic uncertainty. Meanwhile, the contribution of net exports to the GDP growth has been slightly positive due to weak import dynamics while, more recently, exports have been affected by growing trade fragmentation and restrictions. Going forward, after 0.4% in 2023, real GDP growth is expected to remain subdued at around 0.8% in 2024 but to pick up to 1.3% in 2025 and 1.6% in 2026. Stronger private consumption is expected to drive the acceleration in activity in 2025 and 2026 on the back of sustained though slower real wage increases and employment growth. Over the next 2 years, total investment is expected to increase more gradually supported by strong national and EU-financed public investment, while a pickup in external demand is expected to support exports.

(3) Headline inflation surged in the wake of the energy crisis to high levels (peaking at 10.6% in October 2022 for the euro area average), but it is projected to decrease to 2.1% in 2025 and further decline to 1.9% in 2026. Inflation differentials in the euro area, which widened in 2022 have also narrowed in the meantime and are expected to remain close to historical averages. The disinflation process largely reflects an unwinding of the exogenous forces that had led to strong increases in the prices of energy, food, and services over the past three years. It also shows the impact of the decisive policy actions taken by the ECB. In response to the initial inflation surge, the ECB implemented a series of interest rate increases and begun winding down its asset purchases, aiming to keep inflation expectations anchored and rein in prices. While the degree of monetary policy restriction has been recently moderating, policy rates are expected to remain sufficiently restrictive for as long as necessary to ensure that inflation returns to the ECB's 2% medium-term target.

(4) Labour markets remained strong in 2024 despite weakening economic activity. Employment has risen by 3 million in the euro area between the end of 2022 and mid-2024 and the number of jobs reached a record. Employment growth has been strong across age groups, gender, and level of educational attainment. Labour force participation also increased, reaching a new high in 2024 though challenges remain for

women, younger and older workers, Roma and people with disabilities. Like many other advanced economies, the euro area has benefited from large migration inflows, including from Ukraine and other areas, which contributed to labour supply and help to reduce labour shortages in some industries. The euro area unemployment rate stabilized at around the historically low 6.3% in October 2024. The rising trend in labour and skills shortages implied by a shrinking working-age population and new skills demand and compounded by the rapid recovery from the pandemic-induced recession has recently declined somewhat but significant labour shortages remain in multiple industries. Strong corporate profits, and balance sheet dynamics have contributed to robust labour demand. Recently, the share of firms declaring that labour is a factor limiting their production, and the job-vacancy rate have dropped from their historical peaks, although they remain high and above pre-pandemic levels.

(5) In 2023 and 2024, nominal wages have increased on the back of a high inflation environment and a tight labour market. In the second quarter of 2024, nominal compensation per employee grew by 4.5% (euro area average) compared to the same period in 2023, a slightly lower rate than what observed in 2023. The Commission’s Autumn 2024 Forecast estimates robust nominal wage growth in 2024, with moderation expected in 2025. Real wages, which declined in 2022 and in the first half of 2023, began to recover in the third quarter of 2023. The increase in the profit share in recent years, and its subsequent decline, suggests that firms are absorbing increases in wages by reducing profit margins instead of raising prices. Therefore, the ongoing gradual recovery in real wages largely reflects catching-up dynamics and appears consistent with a return to the 2% medium-term inflation target and with well-anchored inflation expectations. Incomes at the bottom of the income distribution were supported by both government transfers and minimum wage increases over the recent year. However, further efforts are needed to promote adequate wages and quality jobs as the risk of poverty remains only marginally lower than in 2019 and financial distress of workers remains high after increasing during the energy crisis, for both the lowest and the lower middle-income households.

(6) The euro area has long-standing structural issues, including stagnant productivity, limited innovation and limited diffusion of digital technologies, high energy prices, and administrative burden, which impact its competitiveness. Total factor productivity growth – a metric of productivity that removes the increase in employment and capital – has stagnated over the past decades, more so than in other international peer regions such as the United States, raising concerns about the euro area’s ability to maintain competitiveness in a global environment marked by rapid technological change. Addressing these challenges requires a multifaceted approach that includes accelerating innovation and the development of advanced digital and clean technologies and infrastructures, including by encouraging the adjustment of business models and tackling of skills shortages as well as by improving access to digital infrastructure, where necessary. Furthermore, facilitating the diffusion of innovation across industries and firms, increasing skills in the labour force, in particular green and digital skills, reducing administrative burden, deepening the single market, while integrating the capital markets of the Union remain also crucial. In addition, higher energy prices than international peers erode the cost competitiveness of several industries. This puts firms at a disadvantage, particularly for what concerns energy-intensive industries relying on oil and gas.

(7) The Union stands out at global level in terms of fundamental (or basic) research, has comparable levels of public spending on R&D vis-à-vis its competitors, but lags in

applied research and in the translation to marketable products, particularly in high-tech digital innovation. It is of paramount importance that the euro area and the Union do not fall behind other major economies for what concerns the current innovation trends, including the green transition, digitalisation, artificial intelligence (AI), semiconductors and quantum computing, space and biotechnology. In view of their growing importance, developing capacities in strategic digital technologies and exploiting our strengths are crucial to reinforcing EU technological sovereignty and resilience and maintaining our open strategic autonomy. Additionally, barriers to the mobility of knowledge and talent across European countries can hinder the full realization of the Union's potential in innovation, productivity, and competitiveness. Boosting productivity will demand an acceleration in innovation and boosting R&D investment particularly by the private sector, including through sufficient and well-calibrated public R&D investments that can leverage private R&D efforts. Investing in human capital has become vital as economies face the pressures of rapid technological change. While tertiary educational attainment in Europe is improving overall, there is a concerning decline in basic skills performance among younger people and far too limited progress in adult participation in learning, hampering education outcomes and productivity growth in the near future. Moreover, the dual transition towards digitalisation and greening requires the development of new skills, from basic to more advanced and specialised skills. All these needs addressing with targeted education and training initiatives. By prioritising education, training, and skills development, the Union can boost innovation, productivity, and competitiveness.

(8) Union's companies need supportive conditions to facilitate economies of scale, foster their growth and scale-up and help them thrive in global markets. Surveys indicate that the complexity of the regulatory environment, cumulative reporting obligations and complicated tax rules often weigh on companies' investment decisions and expansion prospects in the euro area and the Union. Geopolitical tensions, trade restrictions, and economic security concerns, affecting access to critical raw materials and technologies also impact their growth. Accelerating the transition to a more circular economy would help tackle critical raw material shortage and fostering investment with our international partners can further strengthen the competitiveness of the European industry [5],. Mobilising resources for sectors displaying potential for high productivity growth require the removal of bottlenecks to capital and labour reallocation. In the energy market, sufficient grid interconnections and the efficient use of existing ones, in particular cross-border, are crucial for connecting producers and consumers across wide geographic areas. In addition, increasing energy efficiency and the deployment and use of renewable and other low-carbon technologies, also through energy communities, is crucial to enable demand response, increase the role of flexibility and contribute to the reduction of energy costs. The elimination of administrative barriers and facilitating permits can support business activity and investment. Structural reforms supported by Union funds, including the RRF, help boosting Member States' competitiveness. Sustainable growth and development contribute to reduce disparities between the European regions. However, the full potential of the Single Market, more than 30 years after its creation, remains under-exploited. Policies to enhance productivity at national level could be better identified, prioritised, and coordinated. Not all Member States have established National Productivity Boards to this purpose

5 Including with the Global Gateway initiative and Team Europe approach.

or made an effective use of their potential. Intensifying regulatory convergence and economic integration could boost private investment, productivity, and innovative capacity, as well as diversification and the security of supply chains for Union companies. The Union will also need to carefully navigate the possible trade-offs between engaging further in open trade and strengthening economic security, the achievement of the goals of the Clean Industrial Deal while warranting global level-playing fields through further usage of trade defence instruments against unfair trade practice. These calls for a coordinated approach and policy complementarity at both the Member State and Union levels.

(9) Savings in the euro area are abundant. If channelled towards productive investments via capital markets, they may provide significant financing support for the green and digital transformations, helping to close the competitiveness gap. In recent years, tight bank-based financing conditions made it more difficult to invest as a large part of euro area companies rely on the banking sector as a source of financing. However, the cost of credit to companies is decreasing, aligning with the decline in policy rates. Venture capital and non-bank financing, especially for innovative companies, is not as available as in the United States. Although public investment, with the support of the RRF and other Union funds, can play a role, the challenge of enhancing euro area competitiveness, together with supporting green and digital investment entail large private financing needs. Fragmented capital markets cannot provide the adequate scale of financing matching this investment challenge. A European Savings and Investments Union, as suggested by the Letta and Draghi Reports, could foster greater complementarity between the Capital Markets Union and the Banking Union and help leverage the enormous wealth of private savings to provide adequate investment opportunities. This could overall contribute to easier financing for innovation, industrial decarbonisation, and the green and digital transitions. Yet, increasing the pool of investible projects in the euro area would also require deeper integration of goods and services markets, and regulatory simplification.

(10) Recent crises and the required policy reaction resulted in increased levels of government debt and significant deficits in some euro area Member States. This legacy, together with increasing ageing-related costs, poses a challenge to fiscal sustainability for the coming years. Policymakers will need to create fiscal buffers and invest in a fair green and digital transition, social and economic resilience, including the European Pillar of Social Rights, energy security, and where necessary, the build-up of defence capabilities.[6] Achieving this balance will require a careful prioritisation of government expenditures, and coordination of policies to ensure supporting the investments needed to achieve sustainable and inclusive economic growth and to enhance resilience. Prudent fiscal policies will contribute to a balanced policy mix, while financial stability will play a key role in reinforcing the euro area’s economic foundations and securing its position in the global economy. The new economic governance framework, and in particular the use of net expenditure growth as single operational indicator in the implementation of the Stability and Growth Pact, is expected to enhance the role of automatic stabilisers in the euro area.

[6] These efforts will be further informed by the forthcoming EU Preparedness Union Strategy, which will provide a framework for a comprehensive, all-hazards approach to anticipate, prevent, and respond to diverse risks across the Union.

(11) After peaking in the first quarter of 2021, the average government debt-to-GDP ratio for the euro area Member States has been declining, reaching 88.9% of GDP at end-2023. The aggregate debt ratio is set to rise marginally in 2024-25 (to 89.6% of GDP). This projected increase reflects higher debt servicing costs in combination with a slow-down in nominal GDP growth due to falling inflation, while high primary deficits continue to weigh on debt dynamics. At the same time, stock-flow adjustments are set to turn debt-increasing in 2024-25. Public debt ratios differ across countries: by end-2025, most Member States are expected to have a lower debt-to-GDP ratio than in 2020. However, eleven euro area Member States would still have debt ratios above 60%, with five remaining above 100%. With debt for the euro area still above pre-pandemic levels and sustainability challenges prevalent across many Member States, sustained and gradual debt reduction strategies in line with the new economic governance framework are needed to ensure debt sustainability and to rebuild fiscal buffers. At the same time incentivising reforms and investments could strengthen GDP growth, also contributing to fiscal sustainability. The fiscal stance in the euro area is estimated to have been contractionary in 2024 (½ % of GDP) and is projected to be slightly contractionary in 2025 (just above ¼% of GDP). The proper implementation of the new fiscal framework would imply a slightly contractionary euro area fiscal stance also in 2026. After the strong expansions of the past years, this is appropriate in the euro area, although there are large differences among the Member States. Given the need to enhance fiscal sustainability further, and to keep supporting the ongoing disinflationary process, prudent policies are necessary. The gradual and differentiated fiscal consolidation coupled with reforms and investments, as well as the availability of the RRF and other Union's funds, is set to protect economic growth and boost potential growth in the euro area.

(12) Strengthening public finances is crucial for addressing future crises and ensuring the sustainability of pension, healthcare, and long-term care systems. The cost of age-related expenditure is forecast to increase, with significant variations across Member States, particularly driven by rising pension costs, as well as long-term care and healthcare costs. The necessary adjustment to public finances poses challenges, highlighting the need to carefully manage revenue and expenditure. In the euro area, public revenue has remained, on average, steady at around 45.6% of GDP over the past two decades, while expenditure surged during the financial crisis and the COVID-19 pandemic. The revenue ratio is expected to have increased in 2024, due to windfalls from tax revenue and social contributions linked to a strong labour market, and it is projected to rise further in 2025, driven by discretionary revenue measures. However, the current composition of tax revenue may not always be optimal, and the labour tax wedge in the euro area is relatively high compared to other advanced economies. This is particularly relevant in the context of the need to maximise labour market participation in a strong labour market, where labour shortages are a concern. A shift in the tax burden from labour taxation to other taxes that may impact growth less and are less distortive, such as property taxation or environmental taxes, would be beneficial. Targeted reviews of incentives in tax and benefits systems could help alleviate labour shortages while maintaining a stable revenue stream, supporting the necessary adjustment to public finances. Although the total expenditure-to-GDP ratio has decreased since 2021, it remains elevated compared to pre-COVID levels. The expenditure ratio is projected to stabilise at around 49.6% of GDP in 2024-25, as the restraints in primary current expenditure related to the implementation of the new Union fiscal framework would be offset by higher interest expenditure.

(13) The euro area financial system has shown to be robust, in a context of rapidly increasing interest rates, and is now facing an uncertain macroeconomic environment, with subdued loan demand and vulnerabilities in the real estate sector of a number of Member States. In recent years, strong corporate profitability has helped firms to service their debts despite tighter financing conditions. However, weak economic growth and rising labour costs may increase vulnerabilities in some sectors. Most notably, commercial real estate prices have fallen sharply, raising concerns over debt servicing, while residential price developments have strongly diverged among Member States. The banking sector's resilience has been supported by a robust prudential framework, including higher capital requirements and the application of borrower-based measures. Non-performing loans remain low but show signs of deterioration in the real estate sector. The growing non-bank financial sector also faces vulnerabilities where liquidity mismatches are unmitigated and leverage is excessive, that might amplify price adjustments in case of abrupt market correction.

HEREBY 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 2025 –2026 to:

(1) Competitiveness

Foster productivity by moving resources towards high-productivity and high productivity potential sectors, through improved functioning of goods and services markets. Address the fragmentation of the innovation ecosystems and strengthen their ability to generate groundbreaking innovations, including in cutting-edge digital and clean technologies and infrastructure, and raise the adoption of new digital and clean technologies and innovative activities more broadly. Encourage expenditure by businesses on applied research and innovations and the transition to marketable products. Pursue policies to encourage the take-up of digital and high-tech solutions in firms. Enhance firms' efficiency and ability to reach optimum scale, notably by deepening the single market. Improve the business environment by reducing administrative burden and regulatory complexity and by removing investment obstacles. Ensure that industrial policy is effectively targeted towards strategic sectors and technologies, ensuring that public support does not distort the level playing field in the Single Market, and effectively contributes to the competitiveness of the euro areaand its open strategic autonomy. Encourage entrepreneurship and the creation of new businesses.

Develop a European Savings and Investment Union, including by deepening the links between Capital Markets and Banking Union projects, to support growth and investments and improve competitiveness. Further develop the Banking Union by making progress on all its elements and finalise the reform of the crisis management and deposit insurance framework, with the aim of delivering an ambitious, coherent, and effective outcome that addresses the objectives of the review. Adopt the outstanding measures of the 2020 Capital Markets Union action plan and ensure swift implementation of the already agreed measures, and advance work on the measures identified by the Eurogroup towards a competitive and consistent regulatory and supervisory system for capital markets. Improve access to the appropriate funding for businesses to grow and invest, especially innovative SMEs, as well as citizens' access to a larger choice of investment possibilities on capital markets. Leverage Union support through financial instruments to improve access to capital for SMEs, notably for innovation and expansion, maximising the impact of Union funding.Mobilise venture capital – particularly for start-ups and scale-ups – through well-functioning and integrated European capital markets to channel savings and risk capital, both from inside and outside the Union.

Promote upskilling and reskilling of the workforce and quality jobs with a view to increase productivity and support a fair green and digital transition. Foster the labour market integration notably of underrepresented groups, including by enhancing active labour market policies (ALMPs). Improve education and training policies, including vocational education and training, to improve educational outcomes and ensure a better match between demand and supply of skills profiles.

Promote tangible and intangible investment in critical technologies, infrastructure and areas of common priorities, such as the digital and green transitions, and the build-up of defence capabilities by mobilising private capital and ensuring necessary public investment. Stimulate investment in research and development (R&D), particularly by facilitating private sector spending through enhanced framework conditions for investment, structural reforms and by improving coordination of public funding, including at the Union level. Continue the swift implementation of Recovery and Resilience Plans and make full use of cohesion policy programmes. Enhance the effectiveness of policy action aimed at raising productivity by ensuring adequate identification, coordination and prioritisation of measures including by means of improved governance, involvement of local and regional authorities, and more effective use of National Productivity Boards.

(2) Resilience

Further increase labour market participation, facilitate the labour market integration of underrepresented groups, in particular women, young people, low-skilled as well as persons with disabilities, and people with a migrant background. Remove obstacles to the labour force participation including by improving the access to and quality of early childhood education and care and long-term care. Take measures to facilitate,managed legal migration of third country nationals in shortage occupations, in complementarity with fair labour mobility and harnessing labour supply and skills from within the Union.

In accordance with national practices and respecting the role of social partners, strengthen the conditions that support sustainable wage and productivity growth especially for low- and middle-income earners. Wage bargaining should consider the competitiveness dynamics of each Member State and avoid contributing to lasting divergences in competitiveness within the euro area. Ensure the effective involvement of social partners in policymaking and strengthen social dialogue.

Strengthen incentives to work by shifting the tax burden away from labour, including by targeted reforms of tax and benefit systems. Take action in fighting poverty by safeguarding and strengthening sustainable social protection and inclusion systems, including access to affordable and sustainable housing.

Develop and implement a comprehensive Union-wide strategy to complement and bring together national strategies for effective electrification and the green transition, including via a sharp increase in the production of renewable energy and further cuts in the use of imported fossil fuels. In particular, sufficient and efficient grid interconnections, notably cross-border interconnections, are crucial for connecting producers and consumers across wide geographic areas. Step up efforts to improve preparedness for adverse developments, including climate change and nature related risks, especially in regions most exposed.

(3) Macro-economic and financial stability

To ensure compliance with the new fiscal framework and improve debt sustainability, keep the national growth rates in net expenditure in each Member States as recommended by the Council. This should deliver appropriately differentiated fiscal adjustments and an overall slightly contractionary euro area fiscal stance in 2025 and 2026.

When defining fiscal strategies, aim to improve the quality and efficiency of expenditure and revenue measures, aimed at reducing tax avoidance and evasion, and to align the strategies with policy objectives, such as redirecting the tax burden from labour to less distortive tax bases.

Monitor risks to macro financial stability related to asset quality, asset repricing and strengthen macroprudential supervision of the non-bank financial intermediation sector.

In taking further steps in deepening the economic and monetary union (EMU) consider the lessons learnt from the design and implementation of the Union's comprehensive economic policy response to the COVID-19 crisis. Continue making progress in deepening the EMU in full respect of the Union's internal market and in an open and transparent manner towards non-euro area Member States. Continue strengthening the international role of the euro and make further progress in the work on the digital euro.

Done at Strasbourg,

For the Council
The President