The euro area in the world economy and the developments in the next years

2002/2259(INI) - 19/06/2002 - Non-legislative basic document

PURPOSE : to present the Communication from the Commission on the euro area in the world economy - developments in the first three years. CONTENT : this communication notes that the introduction of euro notes and coins at the beginning of this year was a landmark achievement in the history of European integration. The benefits of Economic and Monetary Union (EMU) have been felt already for some time. EMU is based on a commitment to sound macroeconomic policies, which have helped to create a new culture of economic stability in Europe. In turn, this has enabled Europe to weather the recent slowdown in the world economy. Furthermore, thanks to the euro, the kind of damaging intra-European exchange rate tension that often characterised previous episodes of adjustment to external shocks has been avoided. With the euro in place, the citizens of euro area countries can now look forward to the benefits of increased price transparency, more intense competition in the market place and greater financial integration in Europe. In the first two years of the single currency, GDP in the euro area grew by around 3% a year, somewhat above potential, without creating the kind of imbalances that threaten the sustainability of growth elsewhere in the world. In 2001, GDP growth fell sharply as a result of the slowdown in the global economy. Nevertheless, employment creation held up surprisingly well. This reflects, in part, labour market reforms that were carried out in preparation for the introduction of the euro. Whilst inflation has risen from just over 1% in 1999 to around 2.5% in 2001, this mainly reflects a series of one-off adverse shocks, such as food price increases due to bad weather. The available evidence suggests that the euro cash changeover has had at most a marginal impact on overall consumer price inflation in the euro area. Compared to the early 1990s, the macroeconomic policy framework in the countries that now constitute the euro area has been greatly enhanced. This has enabled us to weather the global growth slowdown through a judicious adjustment of the policy mix. The first component of this judicious policy mix is monetary easing, consistent with the ECB's objective of maintaining price stability. The second component is prudent fiscal policy that has relied on the working of automatic stabilizers, where appropriate, with the commitment by Member States under the Stability and Growth Pact to achieve budgetary positions that are close to balance or in surplus over the medium term. In addition, strengthened economic (i.e. fiscal and structural) policy coordination can be achieved by streamlining processes where appropriate and implementing the measures suggested by the Commission and endorsed by the Barcelona European Council. The early years of EMU, as well as the years in the run up to monetary union, have seen an impressive degree of wage moderation. This has contributed to the dynamism in job creation together with widespread product and labour market reforms in most euro-area countries. However, the progress of reforms has been uneven, and there is still high structural unemployment in some Member States. Whilst area-wide wage developments must be compatible with overall price stability, there is also a need for flexibility toreflect productivity differences and factors specific to regions or sectors. Investment is crucial for the euro-area's growth potential over the medium and longer term. It is still too soon to draw strong conclusions about the impact of EMU on investment. Nevertheless, EMU and the policy framework in which it is embedded, are likely to positively affect major determinants of investment such as profitability and real interest rates. EMU will improve financing conditions via greater financial integration. It will also increase the allocative efficiency of investment through reduced exchange rate risk. The pace of integration of euro-area financial markets has clearly accelerated since the changeover to the euro. Deeper integration, due in part to the euro, is reflected in more homogenous markets, a wave of consolidation among intermediaries and exchanges and the emergence of new and innovative products and techniques. The EU has set an ambitious deadline, the year 2005, for the implementation of the Financial Services Action Plan (FSAP) a package of 42 measures to improve the functioning of the EU financial system. An even tighter deadline has been set for actions relating to securities markets and for the Risk Capital Action Plan. The new decision-making framework for securities legislation, adopted on the basis of the proposals by the Lamfalussy Committee should

ensure that legislation can adapt to rapidly changing financial markets. The euro immediately became the world's second leading international currency after its launch. Due to network and scale effects, the US dollar is likely to remain the dominant international currency for the time being. Nevertheless, there are a number of factors that support the usage of the euro as an international currency. The first is the large size of the euro-area economy. The second is the stability attached to the euro, which reflects the sound economic fundamentals in the euro area, underpinned by the stability-oriented policy framework under EMU. The third is the ongoing integration of national financial markets in Europe into broad, deep and liquid pan-European financial markets.