

2007 annual report on the euro area

2007/2143(INI) - 03/05/2007 - Non-legislative basic document

PURPOSE: to present the annual statement on the Euro area 2007.

CONTENT: since last year's Annual Statement on the Euro Area, the euro-area's economic recovery has gone from strength to strength. The euro-area grew by 2.7% last year, its fastest growth rate since 2000, and well-above its long-term average. Employment growth accelerated to around 1.5% in 2006 in the euro area, yielding an increase of close to 2 million new jobs. Inflation remained around 2% in 2006 but it came down towards the year's end as energy prices eased.

The euro-area's positive growth performance partly reflects the current cyclical upturn but it may also show that structural reforms are beginning to take effect. There are signs of an increased resilience to global disturbances. The employment effect of recent growth has been particularly intense. In December 2006, the unemployment rate dropped to 7.5%, its lowest level in 15 years. Labour productivity growth in the euro area averaged 1% in 2006, compared with an annual average rate of 0.7% during the previous decade, and several factors indicate that this rebound could be more than just cyclical in nature. Overall, these developments suggest that Member States are being rewarded for their efforts to, inter alia, increase labour participation rates, boost R&D and innovation, develop human capital and create a more attractive and competitive business environment. They also show the benefits of a macroeconomic framework that is designed to enhance stability and promote greater certainty about medium-term economic prospects.

The prospects for continued economic growth in the euro area are more favourable in 2007 than they have been for many years.

These undoubted achievements put EMU on a strong footing to face the challenges which still lie ahead. These include raising potential growth, enhancing adjustment to economic shocks, putting Europe's fiscal house in order and ensuring a successful enlargement of the euro area.

The main issues dealt with in the report can be summarised as follows:

1) More budgetary consolidation and structural reforms: the robust growth performance last year, combined with the consolidation efforts of Member States, particularly those with excessive deficits, led to a greater than expected fall in the euro-area's budget deficit. The average deficit was 1.6% of GDP in 2006, down from 2.5% in 2005. The Commission welcomes the recent agreement by the Eurogroup to build on the better-than-expected budgetary outcomes in 2006 by pursuing more ambitious budgetary targets than those set in the Stability Programmes. Eurogroup ministers have committed to avoid expenditure overruns and use unexpected revenues to reduce government deficit and debt. They also agreed to carefully design fiscal policy plans for 2008 so as to accelerate adjustment towards their medium-term budgetary objectives, for those that have not reached yet them, and for those which have reached them to avoid fuelling macroeconomic imbalances. By honouring these commitments, most euro-area members that have not yet reached their medium-term budgetary objectives would do so by 2008 and 2009 and all members should aim to do so by the end of the decade.

There are growing signs that reforms by euro-area members are bearing fruit. The employment effect of recent growth has been particularly intense. In December 2006, the unemployment rate dropped to 7.5%, its lowest level in 15 years. There is still a need for further structural reforms to raise the area's growth potential and ensure the smooth functioning of EMU. Raising the growth potential is important in view of the challenge posed by an ageing population in Europe. In the next half-century, we will have only two persons of working age for every senior citizen. If the current trends and policies continue, potential

growth in the euro area will be reduced from above 2% in the period up to 2010 to around 1% on average over the period 2031-2050.

2) Securing sustained economic growth: as the euro area reaps the fruits of the Lisbon Strategy, it must also sow the seeds of further structural reform. As emphasised by EU leaders at this year's Spring European Council with the adoption of specific recommendations for the euro-area, the Lisbon economic reform agenda is critical for boosting growth and jobs in all 27 Member States but it has an added dimension for the countries that share the single currency. In the first place, economic reforms will reduce inflationary bottlenecks in the euro area and help to sustain the economic recovery. In addition, well-functioning product, labour and capital markets are essential for ensuring a smooth adjustment to country-specific economic disturbances under EMU.

In the area of financial market, the euro area should ensure leadership in stepping up the pace of integration at EU level, adding to the impetus already given by the euro. Labour-market reforms are bearing fruit in terms of employment and participation, but more can be done to facilitate adjustment in relative wages across sectors, promote labour participation and facilitate sectoral and geographical mobility. In the area of product market reform, euro-area members have also made progress but there is a need to further enhance competition, innovation and dynamism.

3) Euro area enlargement: on the 1st of January, Slovenia became of the 13th member of the euro area and the first of the 10 countries that joined the European Union in 2004 to adopt the euro. In February, Cyprus and Malta asked the Commission to carry out an assessment on their readiness to join the euro area in 2008. Slovakia wants to adopt the euro in 2009. Regardless of when Member States plan to adopt the euro, policy makers should maintain macroeconomic stability while sustaining the growth necessary to increase living standards. Pursuing policies in line with the economic framework of the Maastricht Treaty and the Lisbon guidelines will allow Member States to adopt the euro and to prosper in the longer run within the euro area.

4) Showing leadership on global issues: the euro now accounts for a substantial share of foreign-exchange transactions and acts as a reference currency in the managed exchange rate regimes of about 50 countries. The share of the euro in the gross issuance of short-term international debt securities also reached 38.3% in the third quarter of 2006, thereby surpassing the share of the US dollar. As the euro's global weight grows so too must its role in global economic governance. Euro-area representatives have actively participated in the IMF's multilateral consultation process on global imbalance, along with those from the USA, China, Saudi Arabia and Japan. This process of consultation on global imbalances has delivered positive outcomes and there is now a broad consensus among policy makers on the policy agenda required to tackle the problem of global imbalances. The priority now is for the relevant actors to implement the agreed policy agenda in a timely manner in line with the IMF's multilateral and bilateral consultations.