Eurogroup
The President

Brussels, 9 December 2022

Dear President,

I am writing to you to inform you about the work that has been taking place in the Eurogroup and our plans for the next six months.

Economic situation and prospects

Our discussions have been taking place in the shadow of the terrible and unjustified Russian war of aggression in the Ukraine, which has led to massive destruction in the country and to soaring prices of energy, food and other commodities globally, further disrupting international supply chains and denting consumer and business confidence. The European economy has been more directly affected than those of our major partners. While the post-Covid recovery has continued well into 2022, we are now facing the prospect of a mild recession, before a gradual improvement in spring next year. Inflation has been driven up by high energy prices and remains at very high levels, but it is expected to start decelerating gradually next year. The labour market, however, with record low unemployment, has been extraordinarily resilient, which testifies to the benefits of the reforms implemented by Member States over the past decade and – more recently – the coordinated support mobilised right across the EU during the Covid crisis. The banking sector continued to show resilience in the face of the challenging environment, which was a reassuring message coming from our regular hearings with the Chairs of the ECB Supervisory Board and of the Single Resolution Board. Nevertheless, the wider economic picture creates a difficult environment for our banks and the financial sector more broadly and will require us to maintain sound policies and to continue our careful monitoring.

In spite of the challenging conditions, the Eurogroup remains confident about the resilience of the euro area economy and its ability to overcome these difficult times. A particular sign of this is the forthcoming enlargement of the euro area in January, when Croatia will become the 20th Member State to use the common currency. This is testament to the open nature of the euro area and a tangible sign of the euro's role as an anchor of stability and prosperity.

The expansion in the euro area reminds us of the important role the euro plays in the global economy. In this context, we have continued our transatlantic dialogue with our international partners and we held a second exchange of views with US Secretary of the Treasury Janet Yellen, which this time took place in Washington, to foster policy dialogue and deepen relations in the economic and financial spheres between our two economies.

We have recently reached another important milestone for the euro area and in particular for Greece, with the ending of enhanced surveillance in August and the return to the standard EU surveillance framework after strong and determined policy implementation. At our last meeting, the Eurogroup also confirmed that the necessary conditions were in place to release the final tranche of policy-contingent debt measures to Greece.

Fiscal policy and coordination

The Covid crisis demonstrated our Union's ability to work together to protect our citizens and the wider world. The euro area's strong policy coordination is the principal tool we have to address the current crisis and to prepare our economies for long-term challenges, which remain no less daunting. Therefore, we will continue to regularly monitor economic and financial developments and work to achieve close coordination of national economic and fiscal policies in support of a coherent policy mix. We have updated our work programme for the first half of next year in this view. I attach it for your information.

The primary focus of our coordination effort over the last number of months has been fiscal policy and in particular the measures to mitigate the impact of high energy prices on vulnerable households and businesses. Supported by the Commission's analysis of the Draft Budgetary Plans (DBP) and of the prospects for the euro area as a whole we have confirmed our assessment that broad-based fiscal stimulus to aggregate demand in 2023 is not warranted. According to the Commission, the euro area fiscal stance is projected to have been clearly expansionary in 2022 and to be broadly neutral in 2023, but we note that it would turn expansionary if significant energy support measures were to be continued throughout 2023.

The energy shock led to a significant increase in the cost of living, which left many of our citizens struggling. Member States had to act timely to protect vulnerable households. They also had to take urgent measures to protect jobs by helping viable companies to withstand the shock. In taking those early measures, Member States prioritised speed and ease of implementation. As the result these measures were predominantly broad based and focused on energy prices. The cost of those measures on national budgets was in many cases high, and they may have reduced incentives to save energy.

As part of our discussions on the appropriate fiscal policy strategy in the euro area, we are working towards improving the quality of the measures, in terms of targeting and timeliness, as well as their contribution to our green goals and objectives of the energy policy, while ensuring their affordability. We are determined to avoid adding to inflationary pressures and to preserve the level playing field in the single market. As part of this work, we will explore whether a well-calibrated two-tier energy pricing model or comparable schemes could help to achieve these objectives, taking into account national specificities. We agree that all such measures should be temporary and progressively withdrawn when the situation in the energy markets stabilise. We have set out our common views in the statement on the DBPs, which I enclose.

A high-quality, rules-based framework is key for effective policy coordination in the EMU. We therefore welcome the publication of the recent Commission Communication on orientations for a reform of the EU economic governance framework and emphasise the need for swift progress so as to enhance policy coordination, particularly with a view to budget policy in 2024. We will discuss - in cooperation with the Council Presidency– the euro area relevant aspects of the economic governance review.

Digital euro

We are continuing our regular discussions on various features that a digital euro could entail, as a contribution to the investigation phase of the project carried out by the ECB and the work of the Commission. We have recently covered issues related to the potential impact of the digital euro on the financial system and the potential business models of private participants. There was a strong agreement among the ministers and the institutions that the digital euro will not replace cash, but is viewed as a complement to it. Still, the success of the digital euro will depend on its attractiveness as a means of payment and the right balance must be found on the various dimensions, including convenience for end users, interoperability with private solutions and cross-border use, as well as privacy arrangements. We agreed that supervised intermediaries should play an important role in the payment and distribution process, and that a digital euro should be designed with due account to preserving financial stability. In view of the importance of the project for our economies and citizens, we are going to continue our exchanges as the investigation phase of the project advances, focusing on its political dimensions.

Lastly, it is my pleasure to inform you that my Eurogroup colleagues have elected me for a second term as Eurogroup President. I am grateful for their support and we will together continue to work on the priorities and areas highlighted above in line with the work programme.

Annex

Brussels, 1 December 2022

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Eurogroup Work programme until July 2023

In January 2023 the Eurogroup will welcome Croatia as a new member in the euro area. The enlargement of the euro area underscores the success of the euro as an anchor of stability and prosperity. This is particularly noteworthy when considering the unprecedented challenges facing the euro area economy. In the wake of the pandemic, supply-side disruptions coupled with soaring energy and commodity prices resulted in a sharp increase in inflation. The outbreak of the Russian war of aggression against Ukraine has profoundly affected the geopolitical and economic landscape. The direct and indirect repercussions of the war have added further to price pressures, rising global inflation to multi-decade highs, while economic growth is expected to slow down markedly amid a more uncertain outlook. Throughout these challenging months, the euro area has once again shown its resilience and its capacity to rise to the challenges. We are confident in our strength and in the ability of the euro area to overcome these difficult times.

Against this backdrop, the Eurogroup has regularly discussed macroeconomic developments, contributing to the European response to unfolding events. Building on the successful coordination during the Covid pandemic, Member States have sought to target fiscal policies, focusing on supporting vulnerable households and businesses, while refraining from policies that would add to inflationary pressures. NextGeneration EU and RePowerEU remain a key instrument to weather downside risks and to support long-term growth through reforms and investments.

The Eurogroup will remain at the forefront of the coordination efforts to address new macroeconomics challenges and longer-term issues, such as the digital and green transitions. The Eurogroup will continue discussions with a view to deepening the Economic and Monetary Union and strengthening its resilience and stands ready to address urgent and unexpected issues that may arise along the way. The Eurogroup will involve non-euro area Member States in matters of common interest and will work closely with the EU Institutions and the Council Presidency to achieve its policy priorities.

The Eurogroup's priority policy areas

In the first half of 2023, the Eurogroup will focus its work on a number of priority policy areas:

Economic and fiscal policies to tackle economic challenges

Given the strong spill-overs and cross-cutting effects, reinforced efforts are required to deliver a determined and agile economic policy response. To this end, the Eurogroup will continue to regularly and closely monitor economic and financial developments and address evolving situations as they unfold. In addition, the Eurogroup will work to achieve close coordination of national policies to support a coherent policy mix. In this respect, the discussion on the 2023 euro area recommendations in January will be a key step towards this goal.

The Eurogroup will have regular discussions on the appropriate fiscal policy strategy in the euro area for the short and medium term. Following the publication of the Commission Communication on the economic governance review in November, the Eurogroup, in cooperation with the Council Presidency and in the appropriate format, will further engage in discussions on the relevant aspects for the euro area, with the aim of building broad-based consensus amongst Member States and institutions.

The global energy price shock has been felt strongly by the euro area, with accelerating inflation and disruptions to the European energy markets. The Eurogroup will continue monitoring inflation developments, paying particular attention to differences among Members, given the uneven impact of the energy price shock across the euro area. We will continue to address the energy price shock in a coordinated manner and to stress the importance of common European level solutions, where appropriate.

With regards to regular reporting obligations, the Eurogroup will remain engaged in post-programme surveillance in Cyprus, Greece, Ireland, Portugal, and Spain, closely working with the institutions involved.

Mindful of the dual objective of the green and digital transitions, the Eurogroup will seek to foster potential growth and convergence within the EMU. In this light, the Eurogroup will continue to hold thematic discussions, focusing on the structural challenges the euro area economy is facing in the current context. We will follow up on previous topics discussed and with an aim of identifying common views and principles for the themes discussed.

Deepening the Economic and Monetary Union

The Eurogroup stands ready to contribute to further work on the deepening of the EMU. Completing the Banking Union and deepening the Capital Markets Union will foster trust and strengthen financial stability, allowing European financial markets to operate in an integrated and transparent manner. We will consider the impacts of the forthcoming Commission legislative proposals on the review of the framework for bank crisis management and national deposit guarantee schemes, which we called for in the Eurogroup statement we adopted in June 2022. The Banking Union is key to support economic growth by providing financing to households and businesses and for mobilising the investments for the green and digital transformation and the energy transition. Ensuring a consistent and effective framework for managing banks in distress is a critical part of the Banking Union.

In view of the current context of war and energy crisis, the Eurogroup could draw lessons from the European response to the COVID-19 crisis, in terms of the benefits of strong policy coordination in the euro area and improving resilience of the Economic and Monetary Union in future shocks.

The euro as a digital and international reserve currency.

The Euro Summit in March 2021 concluded that exploratory work on the possible introduction of a digital euro should be taken forward and the ECB, in cooperation with the Commission, is currently conducting investigations in this direction. A properly designed digital euro has the potential to foster innovation and unlock major benefits for citizens, businesses, Member States and the overall functioning of our EMU. The Eurogroup supports the work carried out by the institutions on a digital euro and will agree on a second work plan for discussions on the digital euro project in January.

During the first half of 2023, the Eurogroup will continue to regularly take stock of the ongoing work of the investigative phase by the ECB and on the future legislative proposals by the Commission, also through the organisation of dedicated technical seminars together with the ECB and the Commission. The Eurogroup work will focus on major design issues and policy-related aspects of a digital euro, in full respect of the institutional roles and mandates of all actors involved. The Eurogroup will regularly return to this topic as the project advances towards the decision whether to proceed to the implementation phase by the end of 2023.

Since its introduction the euro has become an important international currency and the Eurogroup will continue monitoring developments in this regard. In the longer-term, making the euro area more robust by pursuing sound economic policies, deepening the EMU, completing the Banking Union, and building on work on the Capital Markets Union will further strengthen the euro’s international role. The Eurogroup will continue its regular monitoring of exchange rate developments in 2023.

The Eurogroup will also continue to play an important role in coordinating the euro area's position in international forums, especially in the context of the G7.

In the upcoming months the Eurogroup will continue to monitor the plans and actions of non-euro area Member States' relating to the introduction of the euro and will offer its support and guidance, as necessary.

Indicative Work Programme

The work programme for Eurogroup meetings until July 2023 builds on the priorities listed above. In particular, the Eurogroup (in its regular composition or in inclusive format, as appropriate) will continue monitoring the economic situation and policy response needed in the current context. Furthermore, the Eurogroup will prepare and follow up to the Euro Summit meetings.

Given the current uncertain environment, the Eurogroup stands ready to address new challenges that may arise, and therefore the work programme should be seen as indicative. Flexibility is key for ensuring swift reactions to possible future unexpected developments.

Proposed agenda of upcoming meetings

<u>Eurogroup on 16 January</u>

- Macroeconomic developments and policy coordination in the euro area
- 2023 Euro Area Recommendation
- Euro area aspects of the economic governance review
- Article IV review of euro area policies
- Digital euro - Stocktake on the advancement of the project
- Euro area enlargement: update on euro cash changeover in Croatia

<u>Eurogroup on 13 February</u>

- Macroeconomic and financial developments, and policy coordination in the euro area
- Thematic discussion – Euro area labour markets: recent developments and challenges ahead
- (poss.) State of play on ERM II functioning

<u>Eurogroup on 13 March</u>

- Macroeconomic and fiscal developments in the euro area. Fiscal policy guidance for 2024
- Preparation of international meetings – exchange rate developments
- Inflation developments in the euro area and the Members States
- (poss.) Wrap-up of the discussions on the euro area aspects of the economic governance review

In inclusive format

- (poss.) Preparation of the March Euro Summit
- (poss.) Central Bank Digital Currencies, including an update on the digital euro

<u>Eurogroup on 28 April (informal)</u>

- Macroeconomic developments and policy coordination in the euro area
- Thematic discussion – Corporate sector: structural challenges ahead in a context of heightened geopolitical tensions.
- (poss.) Implications of inflation on public finances

In inclusive format

- (poss.) Stocktake on Banking Union

<u>Eurogroup on 15 May</u>

- Macroeconomic developments and policy coordination in the euro area

- (poss.) Digital euro – Stocktake on the advancement of the project

In Banking Union format

- Reporting on Banking Union:
    - o Seventeenth hearing of the Chair of the Supervisory Board
    - o Reporting on recent activities of the Single Resolution Board

<u>Eurogroup on 15 June (in Luxembourg)</u>

- Post Programme Surveillance : Greece, Cyprus, Ireland, Portugal, Spain
- Eurogroup work programme for II/2022
- (poss.) Article IV review of euro area policies

In inclusive format

- (poss.) Preparation of the June Euro Summit

<u>Pm, provisional agenda for the Eurogroup in July</u>

- Macroeconomic and fiscal developments in the euro area.
- Euro area fiscal stance
- International role of the euro – stocktaking
- (poss.) Digital euro – Stocktake on the advancement of the project

Brussels,
5 December 2022

Eurogroup Statement on the Draft Budgetary Plans for 2023

1. We welcome the Commission's Communication and its Opinions on the individual draft budgetary plans, published on 22 November. This exercise continues to be key to the coordination of fiscal policy in the euro area. We welcome that Croatia as a new euro area member from 1 January 2023 decided on a voluntary basis to submit a draft budgetary plan for 2023.
2. The euro area economy continued its strong post-pandemic recovery in 2022, thanks to the swift policy action at national, EU and euro area level, and in spite of the economic impact of Russia's war of aggression against Ukraine. At the same time, high energy price pressures, the erosion of households' purchasing power, a weaker external environment and tighter financing conditions are taking centre stage and heading into 2023, economic activity is decelerating. The euro area and most Member States are at the risk of experiencing a technical recession this winter, with growth projected to return in spring. As the economy adjusts to the rapid succession of two severe shocks, macroeconomic forecasts continue to be surrounded by large uncertainty. The labour market remains a source of resilience going forward, having benefitted also from short term work schemes, including those supported by the EU SURE mechanism, as well as the reforms and policies of the last decade.
3. Based on the Commission forecast, the euro area deficit is projected to continue its decline in 2022 to 3.5% of GDP but is expected to widen in 2023 to 3.7% of GDP. Deficit levels vary significantly among Member States. The number of Member States with deficits above the 3% of GDP Treaty reference value is expected to increase from 10 to 12 between 2022 and 2023 based on the Commission forecast. Public debt in the euro area is expected to decline to 92% of GDP in 2023, decreasing gradually from the 2021 level but remaining well above the pre-COVID-19-crisis level.
4. The euro area fiscal stance is projected to be clearly expansionary in 2022 and to be broadly neutral in 2023, according to the Commission, but would turn expansionary if additional energy support measures were to be enacted or current ones prolonged throughout 2023. Broad-based fiscal stimulus to aggregate demand in 2023 is not warranted, the focus being instead on protecting the vulnerable households and firms, while maintaining the agility to adjust to the rapidly evolving situation, if needed. We agree that fiscal policies should aim at preserving debt sustainability as well as raising the growth potential in a sustainable manner, thus also facilitating the task of monetary policy to ensure the timely return of inflation to the ECB's 2% medium-term target.
5. Given the urgent need to react to the energy price and inflation shock, we have taken emergency measures that could be easily and rapidly deployed. The direct budgetary cost of the measures in 2022 is estimated at 1.3% of GDP in the euro area. Many of these measures have been broad based and focused on energy prices, instead of targeted and addressing incomes. In 2023, the cost is projected at 0.9% of GDP in the euro area, and could increase significantly, if the already announced measures were to be kept in place for the full year.
6. Going forward, as part of our response to mitigate the impact of high energy prices, we are working to ensure that measures are more efficient, better coordinated, while being fiscally affordable. We will in 2023 examine our measures to ensure that they are targeted and focused on vulnerable households and viable firms that are temporarily exposed. A well calibrated two-tier energy pricing model[1] and other schemes that achieve similar objectives, taking into account national features, could be explored. Equally, our measures should support further the reduction of energy dependence on Russia and accelerate the decarbonisation of the economy. This requires preserving the price signal to reduce energy consumption and incentivising investments in energy efficiency, futureproof energy infrastructure, including interconnections, storage and innovative renewable technologies. Given the strong spill-overs in energy markets and for the euro area economies, we will coordinate our measures to preserve the level playing field and the integrity of the single market.

[1] Under a two-tier model, firms and households receive a basic package of energy services at a subsidised price with market prices applying for the energy consumption that exceeds this basic package.

7. The Eurogroup agrees with the Commission's assessment that all Member States should progressively withdraw such measures as energy price pressures diminish. In this regard many of the support measures currently in place are due to expire early next year. We will continue to coordinate our fiscal policy response in relation to energy support in the euro area and will further discuss a common approach for households, including reflecting on appropriate ways to wind down support, at our upcoming meetings, building on the Commission input and experience from euro area members.
8. We recall that the fiscal guidance for 2023 included in the Council recommendation of 12 July 2022 differentiated between those Member States with high and low/medium debt levels, depending on their fiscal and economic situation. Member States with high debt levels should pursue a prudent fiscal policy, in particular by limiting nationally financed primary current expenditure growth. Low/medium debt Member States should aim at a neutral fiscal policy stance. According to the Commission assessment, most high debt Member States' draft budgetary plans are in line with the fiscal guidance contained in the Council recommendation, the plan of Belgium is only partly in line, and the plan of Portugal risks being only partly in line with the Council recommendation, although we recognise the progress made on deficit and debt-reduction in Portugal. According to the Commission assessment, among the low/medium debt Member States, the draft budgetary plans of Austria, Lithuania, Germany, Estonia, Luxembourg, the Netherlands, Slovenia and Slovakia are only partly in line with the Council recommendation. The Eurogroup invites the Member States to take the necessary measures within the national budgetary process to ensure that the 2023 budget is consistent with the Council recommendations, taking into account economic circumstances. As the information on the energy support measures is a key driver of this year's assessment, we welcome the Commission's intention to closely monitor developments and provide an update to inform our upcoming discussions.
9. We welcome that public investment expenditure has been on an upward trend in the large majority of Member States, helped in part by the Recovery and Resilience Facility and we recognise the need to further expand investment expenditure in 2023 and beyond, especially to support the green and digital transition, as well as energy security, including through RePowerEU, once adopted. Moreover, we acknowledge that there is a need to accelerate fiscal-structural reforms which would strengthen potential growth, competitiveness and debt sustainability.
10. We take note that Italy's no-policy-change draft budgetary plan was not assessed as part of this exercise. Italy submitted a full draft budgetary plan on 24 November 2022. We look forward to the Commission Opinion.
11. The Eurogroup remains focused on the long term successful functioning of the Economic and Monetary Union. We welcome the publication of the Commission Communication on orientations for a reform of the EU economic governance framework of 9 November 2022. In cooperation with the Council Presidency and in the appropriate format, we will discuss euro area relevant aspects of the economic governance review. Swift progress on the review is a priority for enhancing economic policy coordination. In the meantime, we welcome the Commission's intention to provide fiscal guidance in March 2023 for 2024; this will be a key input for our regular budgetary planning and coordination efforts. Credible, realistic, gradual and growth-friendly debt reduction remains key.
12. The Eurogroup will continue to closely monitor economic developments and commits to further reinforce our coordination, in order to deliver a determined and agile policy response.