26 September 2008

BUSINESSEUROPE VISIT TO THE ECB
KEY MESSAGES

The outlook for the world economy has deteriorated in recent months, with evidence of a more broadly based downturn in industrialised economies around mid 2008 and increasing turmoil on global financial markets.

In Europe, the current period of weak growth seems to be more directly related to the upsurge in **oil, food and other commodity prices** observed during the first half of 2008, with soaring inflation rates triggering a cascade of negative repercussions for consumers (lower purchasing power and morale) and for companies (rising costs and lower margins). Less dramatic and more protracted factors hampering growth in Europe are the **strength of the euro exchange rate** and more **stringent lending standards** subsequent to the credit crisis.

However, BUSINESSEUROPE is convinced that a **prolonged recession in Europe can be averted** as several structural factors support the economy's resilience. **Labour market conditions** remain supportive, **corporate balance sheets** in the non-financial sector are sound, the **export penetration** of European companies in the world's most dynamic markets is strong and Europe as whole does not suffer from significant housing market imbalances. While these factors should put a limit to Europe's present economic hardships, the **decrease in oil prices since July** and expectations of declining inflation could offer some welcome support to growth and confidence in coming months.

At the same time, the degree of uncertainty for companies and households ensuing from most recent financial market jitters has increased tremendously. The business community is very concerned about future access to finance, citizens' rapidly deteriorating confidence in the financial system, the increasing number of public bailouts raising serious moral hazard concerns and the risk of a regulatory backlash.

BUSINESSEUROPE POLICY MESSAGES

1. Responding to financial market turmoil

- In the short term, **it is imperative for banks and financial institutions to rebuild their capital bases**, clean their balance sheets and develop consistent strategies to dispose of distressed assets.
- Central banks must continue to provide ongoing support by supplying sufficient liquidity to banks and financial institutions against sound collaterals. BUSINESSEUROPE fully **supports the ECB's massive liquidity interventions** to ensure the orderly functioning of money markets. The ECB's credibility and steadiness has been a tremendous asset in the face of present uncertainties.

THE CONFEDERATION OF EUROPEAN BUSINESS a.i.s.b.l.
AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279
TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
WWW.BUSINESSEUROPE.EU

- Regarding the **current interest rate policy of the ECB**, the business community understands the need to keep inflation expectations well anchored in present times. Once inflationary pressures show signs of abating, the ECB should stand ready to cut interest rates to avoid significant spillover effects of financial market turmoil on the real economy, to support growth and avoid renewed upward pressures on the euro exchange rate.
- SMEs face disproportionate consequences when bank lending standards tighten. The EU's overall resilience to the present turmoil critically hinges on its capacity to maintain and facilitate SME's access to finance. BUSINESSEUROPE therefore appreciates recent proposals by the ECOFIN Council to **improve SME access to finance through European Investment Bank facilities**. Generally speaking, much more should be done to help the development of SMEs in Europe, and we have in this regard high expectations for implementation of the recently unveiled **European Small Business Act**.
- BUSINESSEUROPE calls for **more transparency and better coordination** of market supervision. Supervisory convergence should help resolve problems due to banks and financial institutions being essentially regulated and supervised at national level.
- Although they do not carry the entire blame for financial market turmoil, the **role of rating agencies** needs to be assessed. However, it is essential that only the rating process is subject to review and not the content of the ratings.
- In view of the widespread implications of the present crisis, BUSINESSEUROPE advocates a **global approach** that engages partners in a positive dialogue about financial stability. Discussions of standards for banks' capital requirements and possible improvements to the Basle II agreement should not be excluded.
- At the same time, business also emphasises that **hurried solutions to a rapidly evolving financial situation would be counterproductive** and merely lead to increased costs and reduced choices for issuers and investors.

2. Containing inflation and keeping control of public deficits

- BUSINESSEUROPE urges stake-holders to help contain inflationary pressures, as a necessary condition for a sustained growth revival.
  - Social partners must show their commitment to **keep wage developments in line with productivity trends**, thus avoiding a wage-price spiral.
  - Member states should **improve the functioning of crucial market segments** and increase the level of competition in particular in services, energy and retail markets.
- The **Stability and Growth pact must be respected** by all. Governments that have developed sufficient budgetary margins during periods of high growth should allow automatic stabilisers to work freely.
- While rising deficits will not provide a viable answer to present difficulties, all member states should reflect on the **quality of their public finances and tax systems** in order to encourage a supply side recovery of the EU economy.

3. <u>EU's energy and climate change policies and their impact on electricity prices</u>

- BUSINESSEUROPE is concerned that the EU's energy and climate change targets could **create undue pressure on electricity prices and the competitiveness of European industry**.

- Maintaining a healthy industrial base in Europe is a key concern for BUSINESSEUROPE. Three avenues must be followed:

  1. Member states should rapidly implement the **internal market for energy** in order to enhance competition, increase productivity and reduce prices.
  2. The process of granting ETS allowances must follow a pragmatic, evidence-based process assessing the exposure of sectors to international competition. Manufacturing industries exposed to international competition receive 100% free allocations against independently scrutinised technology or efficiency benchmarks unless and until there is an international agreement with equivalent burdens for industry outside Europe.
  3. Effective policies regarding energy and climate change need to be based on an **international agreement**. In the absence of such an agreement, European legislation should be elaborated with care.

- Regarding the **windfall gains for public finances** deriving from the auctioning emission permits, it is vital that these revenues are used to support industrial competitiveness and promote R&D in climate-related technologies, technical improvements, renewables, energy conservation and efficiency measures.

4. <u>Euro exchange rate, China and President Trichet's future visit to Beijing</u>

- At close to 1.50 EUR/USD, BUSINESSEUROPE maintains its positions that the **euro exchange rate remain above the pain-threshold** for European companies. We welcome in this regard the statement of the eurogroup president Jean-Claude Juncker that the euro is currently overvalued.

- The **tight link of emerging market currencies with the USD remains a source of concern** for European companies. The first joint visit of Presidents Trichet and Juncker and Commissioner Almunia to Beijing has been highly appreciated by the business community

- BUSINESSEUROPE is convinced that efficient solutions to global imbalances must be based on **sincere dialogue, in particular with emerging markets**.

- The euro area should **speak with a more unified voice** on global economic, financial and exchange rate imbalances.

- Governments must remain **committed to free trade** and fight protectionism.

5. Structural reforms are the right response to overcome current difficulties

If necessary reforms are not undertaken rapidly, current economic headwinds risk translating into a more persistent downturn and a lower growth potential. The Lisbon Strategy remains the right framework to coordinate member states' structural reforms, but a large implementation gap has exposed two important and related weaknesses:

a) the Community dimension of the strategy has remained under-developed;

b) the Lisbon Strategy has failed to stir strong political interest and public awareness at the national level.

Priorities until 2010:

Implementation of agreed commitments is vital. Peer pressure must be increased, including in the eurogroup. Reliable benchmarking instruments must be further developed and disseminated widely.

Priorities after 2010:

Business is strongly committed to a **competitiveness strategy for Europe after 2010** driving the political agenda of the next Commission. Such agenda should focus on several principles:

a) set a global objective, that allows to better measure Europe's ambition
b) reinforce policies around four pillars
   - deepen economic integration by strengthening the internal market, improving the economic governance of the euro area and foster financial stability
   - enhance innovation, skills and entrepreneurship, building on important synergies between EU and national policies
   - integrate energy, climate change and competitiveness
   - shape globalisation and fight protectionism
c) make better use of the EU budget and EU legislation
d) Create a real benchmarking culture in order to raise political interest and public awareness