International Monetary and Financial Committee

Twenty-Seventh Meeting
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On behalf of European Commission

Statement of Vice-President Olli Rehn to the International Monetary and Financial Committee on behalf of the European Commission

Washington, 20 April 2013

Important policy measures have been taken, and significant reforms are being implemented to overcome the sovereign-debt crisis and strengthen economic governance in the EU, in particular in the euro area. Following these policy decisions financial-market tensions have considerably eased.

According to the Winter 2013 European Economic forecast, the outlook is for a stabilisation in the first half of the current year and a moderate acceleration in economic activity in the second part. In annual terms, **GDP** is expected to contract by 0.3% in the euro area and marginally expand in the EU by 0.1% in 2013. For 2014, GDP growth is projected at 1.4% and 1.6% respectively. The recovery is likely to be initially led by external demand, with investment and consumption gradually taking over as the main drivers of growth in the course of 2014.

HICP inflation in the EU and in the euro area is expected to fall below 2% in 2013, and further in 2014. **Labour market conditions** in the EU have worsened continuously, reflecting the deterioration in the overall economic situation and the heightened uncertainty since the end of 2011. Joblessness steadily increased, particularly among young and low-skilled workers, and in the final quarter of 2012, the unemployment rate hit new historical records in the euro area which is a reason for concern.

The adjustment of internal and external **rebalancing** in the EU is continuing. There is evidence that a shift in production factors from non-tradables to tradables sectors is contributing to a significant reduction of current account deficits in vulnerable economies. At the same time, consumption is expected to hold up relatively well in countries with a current account surplus.

The Euro area has made further progress in the implementation of its **comprehensive crisis response strategy**.

Significant progress has been made to address the problems of **programme countries**. Adjustment programmes in Ireland and in Portugal are performing well, while important challenges remain. Greece has updated its medium-term fiscal strategy in line with the Memorandum of Understanding. The financial assistance programme for the recapitalisation of financial institutions in Spain is being implemented effectively. The Eurogroup has reached a political agreement with Cyprus' authorities on the cornerstones of the policy conditionality underlying a future macroeconomic adjustment programme. Cyprus' authorities are moving forward with putting in place the measures agreed on 25 March.

The stagnation of economic activity forecast for 2013 and the high levels of unemployment emphasise how crucial it is to accelerate efforts to support sustainable **growth** in the EU as a matter of priority while pursuing growth-friendly fiscal consolidation. In March 2013, HoSG endorsed the key messages of the new Annual Growth Survey which gives guidance on priority reforms to be taken at EU and national level during this year. The so-called "European Semester" will culminate in June when the European Council will adopt country-specific recommendations to implement these priority reforms. At the country level, in

addition to the fiscal area, this includes deep reforms in labour and product markets (e.g. to wage setting mechanisms; to enhance competition in services; steps to further open markets in energy, railways and communication sectors etc.) and measures to promote the well-functioning of the financial system. Many of the recommendations translate into crucial structural reforms aimed at strengthening the supply side and growth potential of the European economies, and they will be closely monitored by the European Commission.

At the EU level, the EU HoSG in 2012 have agreed on a "Compact for Growth and Jobs" in order to re-launch growth, investment and employment as well as making Europe more competitive. Several measures are now being implemented in areas such as the Single Market, network industries, SMEs support, and R&D. In this context, HoSG also agreed on boosting the financing of the economy. The European Investment Bank has increased its paid-in capital and thus its overall lending capacity by EUR 60 billion over the next three years. The additional lending will target regions and sectors where financial constraints are the most severe and where investment can be unlocked rapidly. An important recent initiative in this context is also the so-called project bond pilot scheme, which will bring additional investments for pilot projects in key transport, energy and broadband infrastructure.

As part of our efforts to restore sustainable growth in Europe, the EU faces large-scale, long-term productive investment needs, which need to be financed. Europe has a high level of savings and many foreign investments that can supply financing. Yet many factors are holding back the effective channelling of this finance into long-term investment. The current deleveraging in the banking sector creates further challenges given Europe's strong dependence on bank intermediation. Banks will clearly continue to play a key role, but an important question is whether Europe can move to a more diversified system, with greater involvement of institutional investors and higher shares of direct capital market financing. In this context, on 25 March 2013 the European Commission published a Green Paper aimed at initiating a broad debate and public consultation about how to foster the supply of long-term financing and how to improve and diversify the system of financial intermediation for long-term investment in Europe. The Commission welcomes the establishment of a Study Group on financing for investment under the aegis of the G20 and the related work by the OECD and other International Organisations.

In 2012, the **government deficit** decreased in absolute terms in the euro area and the EU, while government debt rose in both areas. According to the Winter 2013 Forecast of the European Commission, the government deficit in the euro area decreased from 4.2% of GDP in 2011 to 3.5% in 2012. Government debt increased from 88.1% of GDP at the end of 2011 to 93.1% at the end of 2012 in the euro area. For 2013, the general government deficit is projected to decrease further to 2.8% in the euro area, while debt is expected to rise to 95.1% of GDP in 2013 and to remain broadly stable in 2014. Sound and sustainable public finances are an essential prerequisite for macroeconomic stability and hence for growth. We remain convinced that there is no viable alternative to consolidation as its absence could lead to even more negative consequences in particular for Member States with reduced market access. But there is a need in the current low-growth environment to conduct the consolidation in a growth-friendly manner. This means that the speed of consolidation has to be differentiated across countries according to their fiscal space, to strike the right balance between potential negative growth effects and the risks to debt sustainability. In particular, countries which have lost access to financial markets or are affected by significant risk premia need to pursue their on-going consolidation efforts. Other Member States should continue to respect their commitments under the EU Stability and Growth Pact, which allows automatic stabilisers to

work around the agreed path of structural fiscal adjustment while ensuring the long-term sustainability of public finances.

Fast and sustained progress is being made towards an effective **Single Supervisory Mechanism** (SSM). Following the political agreement in March, it is expected that the mechanism will enter into force in July 2013 so that the European Central Bank could assume its tasks in full in July 2014. By summer 2013, the European Commission will present a proposal on a Single Resolution Mechanism (SRM) for countries participating in the SSM. This is the next critical step in establishing a Banking Union. The purpose of the SRM would be to resolve banks by applying the resolution tools foreseen in the Bank Restructuring and Resolution Directive directly to banks within the participating Member States. The new proposal will allow for a centralized bank resolution and thus facilitate the establishment of a set of harmonized standards and tools for resolution at European level. Euro area authorities are also working on the operational framework for an instrument that would allow the European Stability Mechanism to recapitalise financial institutions directly. We would like to stress that economic and financial policy coordination in the EU has stepped up to levels which were unthinkable two years ago. The EU has recently agreed on the so called "**two-pack**" of regulations to align economic and budgetary surveillance principles currently used with the Treaty framework and enhance the coordination and surveillance of budgetary processes for euro-area Member States. This, together with the six-pack that was adopted in 2011 and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, represents a further important step towards strengthened economic governance in the Euro area.

In November 2012, the European Commission published a Blueprint on the main features that should constitute a **complete EMU** and which presented the instruments and steps required in the short, medium and long-term. At its December 2012 European Council meeting, Heads of State and Government (HoSG) agreed on taking forward the work on (i) the coordination of national reforms; (ii) contracts for competitiveness and growth; (iii) solidarity mechanisms to accompany such contracts; and (iv) the social dimension of the Economic and Monetary Union. As a first step, the European Commission on 20 March published two consultative communications: one on the ex-ante coordination of plans for major economic policy reforms and the other one on a Convergence and Competitiveness Instrument. On the basis of the feedback on the options and proposals presented in the two communications, the Commission will put forward the necessary proposals in the course of 2013.

The EU is approaching the end of a comprehensive programme of **financial services reform**. We welcome the first IMF Financial System Stability Assessment (FSSA) and in this context the recognition of the progress achieved by the EU to restore financial stability. At the same time, it provides an encouragement to continue in the direction taken. The reform programme includes the timely and consistent implementation of Basel III, following the recent agreement between the European co-legislators; the implementation of the OTC derivatives recommendations through the European Market Infrastructure Regulation (EMIR); a new framework for the prevention, management and resolution of banks and systemically important Financial Market Infrastructures in line with the FSB Key Attributes; enhanced frameworks for securities markets and for the prevention of market abuse through the revision of the Markets in Financial Instruments and the Market Abuse Directives; and a new legislation on Credit Rating Agencies. The recent agreement reached on CRD IV, which transposes into EU law the Basel III agreement, testifies that the EU is in the frontline in promoting a coherent application of Basel III rules to create a level playing field for banks and avoid the instability that would stem from diverging rules in the world's largest financial

markets. The European Commission stresses the importance of continued international cooperation in the implementation of OTC derivatives reform; on reform with regard to banking structures; and on identifying and listing non-cooperative jurisdictions. We remain committed to working with our international partners in this direction.

We have made significant reform progress in recent years to **increase the legitimacy, credibility and effectiveness of the International Monetary Fund**. For us, the Fund is a key pillar of the International Financial Architecture and it is therefore important that we continue our efforts to enhance its capability to address the challenges of today's international monetary and financial system. We believe a continued strong European voice is important for the IMF.

The European Commission welcomes the progress to date on the agreement to **increase IMF resources** which was reached in 2012 at the IMFC and the G20, which resulted in total additional resources of USD 461 billion. We welcome the progress made in completing the implementation process and look forward to the rapid finalisation of the remaining agreements.

We would like to emphasize that **Regional Financial Arrangements (RFAs)** have an important role to play in financial crisis prevention and resolution. Successful collaboration between the Euro area authorities and IMF on joint financial assistance programs and policy advice to Euro area member countries in response to the Euro area sovereign debt crisis demonstrates the value of international institutions and regional financing arrangements working together in line with their relative strengths and roles. Joint programmes make the most of IMF's strong experience of international crisis management, and of the European institutions' detailed knowledge of the specific situation in our Member States and the EU policy settings. Each institution brings its own strengths to the table, which enhances the effectiveness of joint action.

The European Commission welcomes the recent improvements in **Fund surveillance**, including the adoption of the Integrated Surveillance Decision that will ensure a better integration of bilateral, regional and multilateral surveillance and the Fund's Financial Surveillance Strategy, which clarifies the Fund's role in financial sector issues and macro-financial linkages. The recent reforms to Fund surveillance represent progress in enhancing the effectiveness and evenhandedness of Fund surveillance, and implementation will be important. We also think that the Managing Director's Global Policy Agenda will be very useful in drawing the attention of Governors to the key messages resulting from the various surveillance products – in the EU we have introduced something similar with our Annual Growth Survey. We look forward to regular reviews by Fund on the experience with the implementation of these reforms. In this context, some streamlining of the various surveillance products continues to deserve consideration to help foster the traction of IMF surveillance.

All 27 EU Member States have fully concluded national ratification procedures for the **2010 Proposed Amendment on the Reform of the IMF Executive Board and the Fourteenth General Review of IMF Quotas**. The European Commission welcomes the conclusion of the **review of the IMF quota formula** and welcomes the decision of the IMF Executive Board to integrate the discussions on quota formula with the discussions on the 15th General Review of Quotas, which is due by January 2014. We believe that in the context of the integrated package approach the main variables of the quota formula should remain both GDP and Openness which best reflect the role and mandate of the IMF.