



# **International Monetary and Financial Committee**

Twenty-Sixth Meeting  
October 13, 2012

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

**Tokyo, 13 October 2012**

Global economic growth is losing momentum in all major economies, including in emerging markets. Risks to the recovery arise from the euro area sovereign debt crisis, the fiscal sustainability situation in the US, from the very high level of commodity prices and from the economic slowdown in emerging market economies. The balance of risks to the growth outlook is clearly tilted to the downside.

According to the latest estimates by Eurostat, in the first half of 2012, both the euro area and the EU have side-stepped two consecutive quarters of negative **GDP growth**. After output stagnation in the first quarter, GDP has declined by 0.1 and 0.2% in the second quarter, in the EU and euro area respectively. Our central scenario remains that of a mild recession in 2012, followed by a subdued recovery in both the EU and euro area. In 2013, moderate economic growth is expected, but the weaker second half of this year implies that a sizeable negative carry-over into 2013 will first have to be worked out. Any prospect of recovery will crucially depend on the implementation of the policy response agreed at the EU and the international level. Alongside the home-grown headwinds related to the sovereign-debt crisis in the euro area, the unanticipated slowdown of the world economy, with economic weakness in emerging markets and lingering uncertainty about the US recovery, have added to the current subdued economic picture.

Euro area annual **HICP inflation** was 2.7% in September 2012, according to Eurostat's flash estimate, up from 2.6% in the previous month. Owing to high energy prices and increases in indirect taxes in some euro area countries, inflation rates are expected to remain above 2% throughout 2012. They would then fall below that level again in the course of next year and remain in line with price stability. Inflation expectations for the euro area continue to be firmly anchored in line with the ECB's aim of maintaining inflation rates below, but close to, 2% over the medium term. Risks to the outlook for price developments continue to be broadly balanced.

In 2011, the **government deficit** decreased in absolute terms in the euro area and the EU, while government debt rose in both areas. In the euro area, the government deficit decreased from 6.2% of GDP in 2010 to 4.1% in 2011. Government debt increased from 85.3% of GDP at the end of 2010 to 87.2% at the end of 2011 in the euro area. In the Spring 2012 Forecast of the European Commission, the general government deficit in 2012 is projected to decrease to 3.2% in the euro area, while debt is expected to rise to 91.8% of GDP in 2012, increasing further to 92.6% in 2013. As the global economic situation seems to be losing momentum again, should macroeconomic conditions deteriorate further, Member States with more fiscal space should let the automatic stabilizers play along the adjustment path assessed in structural terms and stand ready to review the pace of consolidation. In this connection, the composition of government expenditure and revenues should reflect the growth impact of spending items and revenue sources. In particular, available budgetary margins should be used to foster public investment in the euro area. However, given their particular situation, Member States benefiting from a financial assistance programme should stick to the targets as agreed in the programme and should fully and timely implement the policy measures, including in particular structural reforms, agreed in the respective Memorandum of Understanding. On the other hand, Member States affected by significant and potentially rising risk premia should limit deviations from the nominal balance targets even against worse than expected

macroeconomic conditions. While fiscal consolidation is key to ensure confidence of markets and foster sustainable growth, it should be designed in as growth-friendly a manner as possible by prioritising public expenditure on areas such as human capital, research and innovation. Moreover, the credibility of the consolidation strategy calls for the adoption of the necessary medium-term growth-enhancing structural reforms.

The Euro area is delivering on its comprehensive **strategy for crisis response to address the sovereign debt crisis**.

Significant further progress has been made to address the problems of **vulnerable and programme countries**. The first review mission under the Second Economic Adjustment Programme for Greece is underway. The mission is still on-going and discussions have resumed on 1 October. The Irish programme remains well on track, and Ireland has managed a successful issuance of T-bills in July and September 2012 and also a return to the long term bond market in July and August 2012, underlining its further progress towards the objective of regaining sustainable access to international capital markets during 2013. The Portuguese programme remains broadly on track. The Portuguese authorities continue showing their strong commitment to the programme and have made further progress in undertaking important fiscal and structural reforms in line with the agreed policy conditionality.

As regards Spain, the implementation of the financial sector programme is on track and progressing well. The results of the bank-by-bank stress test published recently show that the capital needs of Spain's banks are below EUR 60 billion, and as such well below the €100 billion maximum made available by the Eurogroup in July for this specific purpose of bank recapitalisation. Over the course of the next two months, recapitalisation and restructuring plans for each bank will be presented to the European Commission for approval, with disbursements of funding foreseen for November. The comprehensive structural reform programme adopted by Spain on 27 September is strongly welcomed. The plan gives new impetus to the structural reform momentum which is critical to generate growth and employment.

We have made further **important progress on short-term stabilisation** since the summer. First, all countries in the euro area have now ratified the Treaty for the European Stability Mechanism and it entered into force on 27 September. The ESM is now fully operational. Second, the European Commission came up with a proposal on 12 September for the establishment of a single supervisor for the euro area which will take over the supervision of EA banks. Third, on 6 September the ECB decided on the modalities of Outright Monetary Transactions (OMTs) in secondary markets for sovereign bonds in the euro area. These three developments have positively contributed in easing tensions on financial markets, strengthening confidence and reducing sovereign bond spreads.

We have also made significant progress on the **implementation of our growth agenda** in the EU. We can see important evidence of rebalancing across the euro area. Wages are being adjusted in line with productivity levels. The adjustment has been particularly strong where external deficits had been very large at the start of the crisis, as reflected in large declines in relative unit labour costs in several countries in 2011. While these adjustments are expected to advance further in 2012-13, surplus countries are recording increasing wages. As a result, euro area internal macroeconomic imbalances are narrowing significantly.

Further progress has been made in the implementation of the "Compact for Growth and Jobs" adopted by EU heads of state and government before the summer. EUR 120bn are being

mobilised for fast-acting growth measures, including through a capital increase of the European Investment Bank, and the use of project bonds for key infrastructure projects. On 3 October, the Commission put forward a proposal for priority actions for completing the EU Single Market, focusing on key drivers for growth, employment and confidence, namely: a) integrated networks, b) cross-border mobility of citizens and businesses, c) the digital economy, and d) actions that reinforce cohesion and consumer benefits.

Finally, the President of the European Council, together with the Presidents of the Commission, the Eurogroup and the European Central Bank, is also working on a specific and time-bound roadmap for the achievement of **a genuine European Monetary Union commensurate with a single currency**, covering the 'four essential building blocks' for the future EMU: an integrated financial framework, an integrated budgetary framework, an integrated economic policy framework and strengthened democratic legitimacy and accountability.

The implementation of **financial reforms** should remain a priority at the global level. It is essential to address the crisis, given the connection with sovereign risk and economic growth. We need to maintain political momentum. The EU fully supports the FSB's enhanced monitoring of the implementation of reforms. This contributes to the important goal of ensuring global consistency and international coordination, in order to minimise regulatory arbitrage and unintended consequences of implementation. We look forward to progress in the framework for Systemically Important Financial Institutions (SIFIs) and in reducing overreliance on Credit Rating Agencies. The EU also supports the FSB's work on monitoring the shadow banking system and developing regulatory proposals for dealing with the riskiest areas. The EU remains committed to fully implementing the new Basel III framework and to strengthening the oversight and transparency of derivatives markets.

We have made significant reform progress in recent years to **increase the legitimacy, credibility and effectiveness of the International Monetary Fund**. It is important that we continue our efforts to enhance the Fund's capability to address the challenges of today's international monetary and financial system.

EU Member States **welcome the agreement to increase IMF resources** at the IMFC and G20 meetings in April 2012 and the additional pledges made at the G20 Summit in Los Cabos, resulting in total additional resources of USD 456 billion. Together with the increase of the European firewalls to support financial stability of the euro area, this will strengthen the ability of the international community to provide effective crisis responses at the global level. We welcome the upcoming signing of a first group of 10 bilateral loan agreements between the Fund and IMF member, for an amount of USD 268 billion and encourage other contributors to take the necessary actions to make their commitment effective quickly.

The EU welcomes the **recent improvements in the IMF's surveillance** toolkit with the adoption of the Integrated Surveillance Decision, the adoption of the Fund's Financial Surveillance Strategy and the pilot External Sector Report. With respect to the latter, we look forward to the continuous review and adjustment of the methodology and data used in the External Balance Assessment exercise, in particular to take into account the specificities of countries within currency unions. Beyond the recent improvements in Fund surveillance, the EU considers that the coverage of financial sector issues, macro-financial linkages, and the assessment of risks should be further strengthened in IMF surveillance, as well as the identification of adverse feedback loops between financial sector developments and the real economy. The recently adopted Fund's Financial Surveillance Strategy, which clarifies the

role of the IMF in this area, represents an important step forward to this end. We also look forward to the presentation of a comprehensive capital flows framework by the Fund. A streamlining of the increasing number of surveillance products would be welcome in order to help foster the traction of the policy advice and to focus the Fund's messages.

Finally, full implementation of the 2010 IMF **quota and governance reform** is of utmost important. We reiterate the urgency of promptly concluding the agreed reform, and urge all countries that have not yet implemented the necessary domestic procedures for the quota increase and the Board Reform Amendment to complete the ratification process. 22 EU Member States have already fully concluded national ratification procedures. Advanced European countries reaffirm their commitment to reduce their Executive Board representation by two chairs by the time of the first regular election of the Executive Board after implementation of the 2010 quota and governance reform. EU Member States will continue to play a constructive role in the discussions on the review of the current IMF quota formula. The four principles which underpinned the 2008 reform of the quota formula continue to provide the appropriate basis for the current review. In particular, EU Member States believe that it is important that the formula seeks to capture the multiple roles of quotas. It is therefore of utmost importance that GDP and openness should remain the main variables in the quota formula. Openness should carry an increased weight in the formula. Further governance reforms to improve IMF accountability, oversight and effectiveness should be an integral part of further discussions on IMF governance and quotas. Enhanced engagement of ministers and central bank governors in the strategic oversight of the IMF is needed.

We would also like to recall the need for IMF members to fully respect their **obligations under the Articles of Agreement (AoA)**. In particular, access to information that is as timely, complete and accurate as possible is essential for every aspect of Fund's activities, including crisis prevention and resolution. In order for the Fund to be able to carry out its responsibilities, we stress the importance for IMF members to respect their obligations regarding the provision of information according to Article VIII, Section 5 of the Article of Agreements.

We welcome the recent review of **IMF facilities for low income countries (LIC)** which provides a good starting point for further discussions on this issue. We recognize the importance of the Fund's role in helping to address balance of payments problems, mitigating shocks and supporting macroeconomic stabilization, growth, and poverty reduction.