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On behalf of the European Commission

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Economic outlook

While real GDP growth has remained positive for the euro area as a whole during the first half of 2014, the recovery in the EU is weaker than expected. However, countries that implemented ambitious reforms have seen economic activity picking up albeit from low levels whilst the recovery has lost momentum in large euro area countries.

Inflation in the EU has continued to decelerate over the last months. While the recent decline is mainly the result of falling energy and food price inflation, it is also due to the weaker-than-expected recovery and reflects past euro appreciation. Underlying inflationary pressures, as reflected in measures of core inflation, have remained relatively stable. Looking ahead, the European Commission expects inflation in the EU to remain low for some time and to increase only slowly over 2015, supported by a lower euro and a gradual strengthening of economic activity.

The growth agenda

In Europe, we need to act on three fronts to boost growth. First, we need to speed up structural reforms. No country is immune from the need to reform. Bold reforms, effectively implemented, can deliver benefits relatively quickly – lifting confidence, lowering prices and improving services for consumers, helping companies create jobs. Second, we need to ensure sustainable fiscal policies and smarter public spending. Smart fiscal consolidation means avoiding excessive tax rises and shifting the burden of taxation from labour and production to consumption and environmental levies; prioritising key investments over inefficient current expenditure; countries with large current account surpluses should invest more. Third, we need to use all available tools to support investment. The incoming European Commission will work swiftly to mobilise significant extra investment as announced by President-elect Jean-Claude Juncker.

Our comprehensive strategy going forward includes several key elements:

- All Member States have made significant efforts to implement structural reforms. However, more efforts are needed, in particular to improve framework conditions for starting and operating firms, for encouraging investment, and for improving the functioning of the labour market. This summer, the EU agreed on its annual set of country-specific recommendations on reforms that support growth and employment. Back in the spring, the EU identified the existence of macroeconomic imbalances in 14 Member States and excessive imbalances in three Member States. The European Commission is monitoring reform progress in all Member States and will track the policies recommended by the EU Council to the Member States. The European Commission will take stock of progress made in its Report on the Macroeconomic Imbalances Procedure and in the Annual Growth Survey in late autumn. The European Union is also approaching the halfway point of its Europe 2020 growth strategy. The European Commission has launched an EU-wide public consultation to gather the views of all interested parties on the first years of implementation of the Europe 2020 Strategy and on the elements to take into consideration in the further development of the strategy. The consultation will conclude in end-October. We will adopt the European Commission proposal on the mid-term review of Europe 2020 in time for discussion at the March 2015 European Council.

- Given the sharp increase in deficit and debt levels across the EU during the financial crisis, a significant degree of fiscal consolidation was necessary to return sustainability to Member States' public finances and also, for some countries, to maintain access to borrowing markets. The large consolidation efforts implemented over recent years have led to visible results and the average headline deficit in the EU is now forecast to decline below 3% of GDP this year. This achievement has allowed a reduction in the pace of fiscal consolidation overall, even though large differences across EU countries remain. However, we are also extremely conscious of the need to support economic growth. The Stability and Growth Pact provides the appropriate framework to deliver long-term growth in the context of sustainable public finances, including flexibility where required. The European Commission considers that all consolidation strategies should be backed by sufficiently ambitious growth- and employment-enhancing reform programmes. In this respect, it is welcome that Member States' plans set out in the recent Stability and Convergence Programmes show a switch toward a more balanced and growth-friendly adjustment. Countries that are facing the largest fiscal challenges are naturally planning to implement the largest consolidation efforts, but where fiscal space is available, it can be used. Finally, in cases of severe economic downturn in the euro area or the EU as a whole, the pace of fiscal consolidation can be adapted for all Member States as appropriate, provided this does not endanger fiscal sustainability in the medium-term.

- Europe is putting more focus on investment. The European Commission is now implementing a set of actions it has formulated in its Communication on the long-term financing of the European economy on 27 March 2014. These actions focus on six areas: i) mobilising private sources of long-term financing, ii) making better use of public finance, iii) developing capital markets including reviving sound securitisation instruments, iv) improving small and medium enterprises' (SMEs') access to finance, v) attracting private finance to infrastructure, with a view to establishing infrastructure projects as an asset, and vi) enhancing the overall environment for sustainable finance. [1] Commission President-elect Juncker has underlined the importance of investment as part of his Jobs, Growth and Investment Package. This will draw on the common EU budget and the European Investment Bank (EIB) to "mobilise up to € 300 billion in additional public and private investment in the real economy over the next three years". Concrete proposals are currently under preparation and will be tabled by the new Commission.

- With unemployment at historically high levels, creating the conditions for a job-rich recovery remains a key challenge for the EU. The recommendations for labour market reforms, annually addressed to the Member States in the framework of the Europe 2020 Strategy, consistently focus on (i) supporting demand for labour, (ii) keeping up the incentives to work, and (iii) improving the adjustment capacity of labour markets. Over the last couple of years, the EU has also stepped up its efforts to combat youth unemployment. In this respect, recommendations are addressed to Member States to enhance the employability of young workers, improve labour market matching and school to work transitions, support labour demand and job creation, including by means of the establishment of a Youth Guarantee scheme, whereby all young people up to 25 are offered a good quality offer of employment, continued education, an apprenticeship or a

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traineeship within four months of leaving formal education or becoming unemployed. EU financial support to fight youth unemployment has been raised and targeted to the regions most concerned. Finally, labour mobility within countries and across Europe is being boosted.

Financial market regulatory reform

The EU has made decisive progress towards securing a centralised system of decision-making, supported by a 'single rulebook' of common tools and powers applicable to all EU Member States. The two pillars of Banking Union nearing completion represent a game-changer in how the EU will address fragmentation and the sovereign-bank nexus. Following the publication of the results of the comprehensive assessment of the banking system by the European Central Bank, the Single Supervisory Mechanism will take up its full responsibilities in November 2014. The exercise includes 131 credit institutions across 19 Member States, covering around 85% of bank assets in the euro area. The stress test will furthermore be accompanied by a complimentary exercise run by the European Banking Authority covering all EU-28 banking sectors. Although we are not yet across the finishing line, Banking Union will serve to underpin long-term financial stability by improving banking sector health and resilience via improved capital requirements, and regulating the prevention and where necessary management of bank failures. Building a "Capital Markets Union" to complete the single capital market will be particularly important. More developed and integrated capital markets could reduce Europe's strong reliance on bank financing and mobilise alternative sources of finance, addressing in particular the needs of SMEs, and ensuring the financing of the economy. The development of high quality securitisation is particularly important in this respect.

The EU has largely completed the implementation of the core financial reforms set out by the G20 in response to the global financial crisis especially with the implementation of Basel III, resolutions frameworks, deposit insurance, derivatives reform, strong compensation rules, and strict requirements for rating agencies and for hedge funds. The EU calls on all G20 Members to complete the implementation of the reforms in their respective jurisdictions. Regulators should continue to monitor developments in the global financial markets and remain vigilant to new or emerging risks. In this regard, important work will continue beyond 2014 as we strengthen oversight of shadow banking, while being mindful of the potential for alternative sources of finance. The consistent implementation across all jurisdictions will ensure a global level playing field for financial regulation, avoid of conflicts, inconsistencies and duplication of regulation, while at the same time providing for the comprehensive regulation of financial markets. Regulatory cooperation is therefore essential in this context. G20 members should have the possibility to defer to each other’s regulatory regimes, when justified by the quality of their respective regulatory and enforcement regimes and where they achieve equivalent outcomes.

IMF Issues

The International Monetary Fund is a key pillar of the International Monetary System. It is important that we continue our efforts to ensure the Fund's capability to address the challenges of today's international monetary and financial system.

Our priority continues to be for all IMF members to ratify the 2010 Quota and Governance Reform as soon as possible. We attach high importance to securing this objective. All 28 EU Member States have already fully ratified. We encourage all IMF member countries that have not yet ratified, to do so expeditiously. The implementation of the IMF 2010 Quota and Governance Reform is key to the Fund's legitimacy and will result in a governance structure that better reflects the realities of the world economy. EU Member States reconfirm that they remain committed to continue constructive discussions on the quota formula and the 15th General Review of Quotas. In this regard, we look forward to the IMF building on its existing work and developing options for the next step in case the 2010 reforms are not ratified by year-end, as agreed by the IMFC in April 2014.

We strongly support the commitment in April 2014 by the IMFC and G20 Finance Ministers and Central Bank Governors to maintain a strong and adequately resourced IMF. In this respect, we strongly welcome the one-year extension of the initial two-year terms of the 2012 Borrowing Agreements and the establishment of a new activation period under the New Arrangement to Borrow for the period October 2014 – March 2015.

The European Commission welcomes the 2014 Triennial Surveillance Review (TSR) as an opportunity to take stock of the progress made in Fund surveillance in recent years. The following recommendations are a priority for us in this review: strengthening IMF analysis of spillovers; widening the macro-financial surveillance and in this context better integrating FSAP recommendations into Article IV reports; continuing to integrate bilateral and multilateral surveillance and further defining the role of the Fund in providing policy advice on structural reforms, taking advantage of cooperation with international organizations, including the European Commission, in this respect.

With respect to the specificities of EU/euro area surveillance, we emphasize that country surveillance should take due account of the degree of interconnectedness of IMF members participating in deeper forms of economic or monetary union. Fund surveillance and advice should fully reflect the specific policy-making frameworks and respective competences at Member State, euro area and European Union level. With a view to providing more consistent and effective surveillance, and in light of the recent reforms to strengthen European economic governance, further work by staff should focus on an analysis of spillovers to understand the impact of shocks and policy decisions; further analysis of extra- and intra-euro area imbalances; better alignment with the European policy timetable and more considerations on the euro area-wide macroeconomic policy challenges including the provision of stronger and more clearly formulated policy recommendations on structural reforms. Continued close cooperation between the IMF and the European authorities will help ensure the high quality of policy advice. The European Commission looks forward to deepening its work with the IMF to this end.

The European Commission supports the regular conduct of Financial Sector Assessment Programs and Article IV consultations, as well as mandatory and timely publication of annual Article IV reviews. Systemically important countries/regions should lead by example. We call on all IMF members with overdue Article IV consultations and deficiencies in the provision of data to the Fund to fully cooperate with the IMF in line with their membership obligations. The availability and quality of economic data is essential to the proper conduct of IMF surveillance.