International Monetary and Financial Committee

Nineteenth Meeting
April 25, 2009

**Statement by Commissioner Joaquin Almunia
On Behalf Of The European Commission**

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to the International Monetary and Financial Committee
on behalf of the European Commission
Washington, 25 April 2009

The financial crisis has resulted in increasing international cooperation and coordination of policies to alleviate the fallout to the world economy. The **London Summit** has shown the determination of Leaders to act in unity and to take decisive action, which will minimize the costs of the crisis while laying the foundations for a more balanced growth path for the world economy. By working together to tackle the crisis, Leaders have demonstrated to citizens their conviction that there is a way out of this crisis. This should help to lift confidence and initial market reactions suggest that this is already the case. This IMFC meeting must continue in the same spirit and build upon the agreement by Leaders.

The **Summit** achieved consensus on several key issues, notably achieving a good balance between restoring growth and reforming global financial markets and between the need for concrete action now and safeguarding medium-term economic and fiscal sustainability. The scope and scale of regulation will be significantly increased, including regarding non-cooperative jurisdictions. The Summit placed the appropriate emphasis on developing and emerging countries, as demonstrated by the significant strengthening of resources for the international financial institutions (IFIs), the inclusion of all G-20 countries in the Financial Stability Board, the initiative on trade finance, the agreement to pursue IFI governance reform, the extension of the stand-still agreements and the political commitment to drive the Doha Round forward.

From the outset, **the EU** has been at the heart of the G-20 initiative; we are committed to continuing our strong engagement also in the implementation and monitoring phase, which has begun in earnest and which needs to be pushed forward with resolve.

The crisis has exposed unacceptable weaknesses in the current governance of international and European **financial markets**, which have proved real and systemic in times of serious turbulence. In implementing the Communiqué of the Leaders Summit, the European Commission will propose an ambitious reform of the European financial system in the course of 2009.

The reform will have five key objectives: (i) to provide the EU with a supervisory framework that detects potential risks at an early stage and deals with them effectively before they have an impact; (ii) to fill the gaps where European or national regulation is insufficient or incomplete, for example concerning hedge funds, over-the-counter derivative markets, and introducing tools for early intervention; (iii) to ensure that European investors, consumers, and small and medium sized firms can be confident about their savings and can access credit; (iv) to improve risk management in financial firms and to align pay incentives with sustainable performance; and (v) to ensure more effective sanctions against market wrongdoing.

Many European Union governments have already taken bold measures to support **financial stability**, and have acted decisively to restore confidence in the financial markets and to minimize the risk of a serious credit crunch. Financial support measures include recapitalisation of banks, the setting-up of asset relief programmes, and guarantees on bank borrowing.

So far, about EUR 270 billion has been committed for the recapitalisation of banks. Of this amount, some EUR 150 billion has already been injected. This amounts to 2.1% and 1.2% of EU GDP respectively.

More than EUR 2.800 billion has been committed to guarantees on bank borrowing, of which some EUR 880 billion has been allocated. This amounts to 22% and 6.8% of EU GDP respectively.

These measures have averted a meltdown in the EU banking sector. However, the banking sector and interbank markets remain fragile.

Because of the spillover of the financial crisis to the real economy, the **EU is now in the middle of a severe recession**. GDP contracted sharply in the final quarter of 2008. Ongoing housing corrections add to the decline in economic activity in some Member States, while in others, external financing conditions have deteriorated.

Looking ahead, the outlook for the **economic situation** in the EU will continue to be exceptionally uncertain. While the actions taken by Governments and Central Banks in recent months are helping to stabilise EU economies, financial markets and institutions remain under stress and confidence in the banking sector is still relatively low. On the real side, hard indicators continue to paint a bleak picture, though the latest soft data has been more mixed. As such, and notwithstanding the offsetting impact of automatic stabilisers and the various recovery packages, economic activity in the EU is expected to remain depressed in 2009. Indeed, a substantial downward revision to EU growth is in prospect in the Commission's forthcoming spring 2009 forecast. For 2010, some stabilisation might be expected. However, given the prevailing level of uncertainty, risks to the economic outlook remain sizeable. Of particular concern is the possibility that the negative feedback loop, from the deterioration in the real economy to the still fragile financial sector, will intensify. On the other hand, there are also some upside risks, in particular if the full and swift implementation of the policy measures introduced so far prove effective in restoring financial market stability and confidence, thereby supporting the economy better than currently envisaged.

The crisis has contributed to rapid **disinflation**. Despite the sharp falls in inflation, and possibly some negative inflation rates in the months ahead, a deflation scenario in the euro area remains highly unlikely. Medium-term inflation expectations appear to be well anchored at a level consistent with price stability, wage growth is expected to remain positive, and both fiscal and monetary policies are expansionary. Since October 2008, the ECB has lowered its key interest rates by 300 basis points. In addition, it has provided unlimited funds against an expanded range of eligible collateral and re-widened the interest rate corridor.

An important weapon in the fight against the financial crisis has been **fiscal policy**. In the EU, short-term fiscal support has been provided by the adoption of sizeable fiscal packages in line with the European Economic Recovery Plan (EERP) endorsed by the European Council in December 2008, and by the operation of the automatic stabilisers, which are the largest among advanced economies. Government deficits in the EU may exceed 6% of GDP, on average in 2010, thus providing a sizeable additional fiscal support.

The negative financial market dynamics of late 2008 and early 2009 appear to have calmed somewhat in **non-euro-area Member States**, but the situation remains fragile, including in view of high uncertainties on the outlook. However, economic conditions vary widely between countries, reflecting in particular differences in the domestic and external imbalances. Financial stability indicators suggest that banking sectors in the new Member States have so far proved broadly resilient in terms of liquidity and capitalisation. In particular, there have not been negative effects of rescue packages in the other Member

States, and financial sector support measures from home Member States have been accessible to subsidiaries in new Member States. Nevertheless, there are potential risks going forward regarding rollover and liquidity needs and deteriorating asset quality if the economic situation deteriorates.

The European Community has extended **balance-of-payments financial assistance** to Hungary and Latvia. A decision on Romania is expected in early May, when EU Finance Ministers should also ratify a doubling in the ceiling of the EC balance-of-payments facility to EUR 50 billion. EC assistance is provided in conjunction with the IMF and other donors. The EU and the IMF in particular have been working closely together, including in agreeing policy conditionality underpinning the programme with the authorities. We attach great values to such close cooperation, which allows a leveraging of financial resources, a pooling of expertise and consistency in policy conditions.

Since the last quarter of 2008, the economies of candidate and potential candidate countries, both in the **Western Balkans and Turkey,** have also been seriously affected by the crisis. Output in a number of these countries may contract abruptly in 2009 and the macroeconomic stability that has been achieved over the past decade may be seriously jeopardized. Market conditions and access to external financing have also deteriorated in other countries neighbouring the European Union. At the present juncture, IMF and World Bank support, together with financing from other IFIs active in the region, is absolutely crucial to address financing gaps.

The crisis is resulting in a sharp contraction of **global trade**. It is vital to keep markets open, avoid protectionist pressures and promote trade. The Commission strongly supports an ambitious and balanced conclusion of the **Doha Development Round**. The EU also supports the initiative to make available at least $250 billion over the next two years for trade finance.

In recent month developments of the world's major **currencies** have largely been driven by differences in the scale and speed of monetary policy loosening and portfolio shifts as a result of changes in risk aversion. Although some reduction in volatility has been observed, the risk of abrupt exchange rate moves remains elevated. The euro has strengthened in real effective terms, and is at some 10 percent above historical averages.

The G-20 London Summit also injected momentum into IMF crisis prevention and crisis resolution efforts. Significant progress has been made on several fronts but the agenda is far from finished and additional efforts are required by the international community to live up to the aspirations of the Leaders' Summit.

The crisis has brought to the forefront the question of **IMF resources**. European Member States have agreed to make EUR 75 billion available to the IMF in form of bilateral loans which will be transferred to a revised New Arrangements to Borrow. It is now up to other advanced and emerging markets to make financial commitments to allow for the creation of an adequate global financial safety net. In this respect, the general SDR allocation of USD 250 billion will meet the financing needs of the many emerging markets and developing countries that have become innocent victims of the financial crisis. We also need to make further efforts to equip the concessional lending arm of the IMF with adequate resources. Care needs to be taken to ensure that this additional lending will not lead to unsustainable debt situations in the future.

The current crisis makes clear that we need to increase efforts to put the linkages between the financial sector and the real side of the economy at the forefront of our policy agenda. The IMF-FSB joint early warning exercise will increase our understanding of the spillovers from the financial sector to the real economy and of potential systemic implications. Further progress to improve the Financial Sector Assessment Programme is also necessary, allowing overall **surveillance** to become even more effective. It will be important then that IMF members to implement the policy recommendations coming from the IMF.

Global imbalances are expected to remain large, and even recent improvements may be unwound as the recovery takes hold. In the medium term, continuing to reduce global imbalances and moving towards a more balanced global growth path will be essential to limit the risks of a repetition of the crisis and to reduce the risk of a disorderly correction through exchange rates. The broad strategy agreed at the IMF multilateral consultations remains relevant in the medium term and should continue to be implemented, though with due regard to the current cyclical conditions. The option of reactivating the Multilateral Consultations mechanism should be considered.

The IMF has also made decisive efforts in improving its **lending kit** and in streamlining its conditionality. The introduction of the Flexible Credit Line (FCL) is welcome. Initial market reactions to the announcements that both Mexico and Poland will seek financial assistance from the IMF in form of the FCL have been very positive. We now need to ensure that the FCL is applied in a consistent manner with a rigorous assessment of its qualification criteria. This will ensure that the FCL becomes an effective crisis prevention tool. We also encourage an overhaul of the IMF's instruments for its low-income countries.

The 2008 **quota and voice** package needs to be urgently ratified by those members which have not yet done so. Its ratification will form the appropriate basis for the next quota and voice reform. We welcome the fact that its conclusion will be brought forward to January 2011. These discussions should not prevent progress on the other parts of the IMF's outstanding governance reform agenda. The Manuel report has made many valuable recommendations in this respect. The IMF will be well advised to conduct in-depth discussions on the role of the IMF Board and management, and on voting modalities and decision-making procedures. All parties involved should approach these issues with an open mind and willingness to compromise.

Many **developing countries** are more resilient than in past crises because of better economic policies, lower indebtedness and higher foreign reserves, but they are significantly constrained in their policy response and strongly dependent on external support to manage the crisis. Advanced countries need to keep their aid promises, and should frontload and refocus existing commitments on the most vulnerable. In addition, aid should more effective by working better together. In this regard, the European Commission has proposed a number of measures for the EU to support developing countries in coping with the crisis.

Important efforts have to be made by all parties to reach an ambitious agreement at the UN Conference on **climate change** in Copenhagen next December. The EU is currently leading the fight against climate change. We have decided to reduce our greenhouse gas emissions to 20% below 1990 levels by 2020 and are committed to reduce emissions by 30% if an ambitious agreement is reached.

We support the development of a **global charter for sustainable economic activity** as well as proposals to create legal standards that would form a basic set of rules on propriety of international activities and transparency, which the international community should respect.