International Monetary and Financial Committee

Twenty-Eighth Meeting
October 12, 2013

Statement by Olli Rehn,
Vice-President, European Commission

On behalf of the European Commission

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

Washington, D.C. 12 October, 2013

The latest economic data point to a gradual recovery in the Euro area. GDP rose by 0.3% in the Euro area in the second quarter of 2013, quarter-on-quarter. Improving business activity and sentiment provides encouraging signs, including in vulnerable countries whose economies have begun to stabilise. The latest GDP release also shows a strong export performance in some vulnerable member states and welcome signs of strengthening domestic demand in the core.

The recovery in the EU and euro area is likely to be modest and gradual, and the outlook for the second half of the year remains broadly in line with the spring forecast of the European Commission of 3 May (-0.4% and -0.1% in 2013 with growth accelerating in 2014 to about 1.2% and 1.4% in the Euro area and the EU respectively).

The level of unemployment, especially youth unemployment, is a key concern for European policymakers. Unemployment is forecast to reach 12.2% and 11.1% in the Euro area and the EU respectively in 2013 and to stabilise at these levels in 2014.

Headline inflation is expected to average 1.6% in the Euro area in 2013 and to decline further to 1.5% in 2014. Underlying price pressures are expected to remain subdued, reflecting the broad-based weakness in aggregate demand and the modest pace of the recovery.

There has been good progress with the implementation of adjustment programmes across EU vulnerable countries, which are starting to bear fruit. Continued full and timely policy implementation is essential for the success of the programmes. In Spain, as a signal of the very important reforms and increased competitiveness, exports of goods and services now make up 33% of GDP, more than ever since the introduction of the euro. Ireland has been able to draw money from capital markets since the summer of 2012, the economy is expected to grow for a third consecutive year in 2013 and Irish manufacturing companies are re-hiring staff. In Portugal, the external current account, which was structurally negative, is now expected to be broadly balanced, and growth is picking up after many quarters in the red. Greece has completed, just in 3 years, a truly remarkable fiscal adjustment, is regaining competitiveness and is nearing for the first time in decades a primary surplus. And Cyprus, that has started the programme later, is also implementing it as scheduled, which is the pre-condition for a return to growth.

There has also been significant external adjustment in euro area countries with previously high current account deficits. As a group, these countries actually recorded a surplus of 0.9% of their GDP in 2012. According to our analysis, a major share of this adjustment is non-cyclical and as such will not necessarily go away once the overall economic situation improves. Improved competitiveness indicators - recent improvements in unit labour costs and the relatively robust export performance - point to a more lasting non-cyclical effect of the structural reform efforts undertaken so far. On the other hand, progress in the reduction of the largest current account surpluses has so far been limited.

The EU strategy to strengthen the recovery is focused on four elements that should help to make the improved situation more durable:

First, the EU fiscal strategy focuses on structural balances, and is differentiated by country. Fiscal consolidation will continue in 2013, but at a slower pace than in 2012. Sound public finances are key to ensure confidence of markets and thereby foster sustainable growth, particularly in the case of a currency union. Thus, concerns about fiscal sustainability and fragile market confidence in a number of euro area countries called for a medium-term strategy aiming at ensuring a lasting reduction of public deficit and debt levels. European fiscal rules promote differentiated fiscal consolidation, according to each Member State's fiscal space; focus on progress achieved in structural rather than purely nominal terms, that is, corrected for the impact of the economic cycle and one-off and temporary measures, and pay special attention to growth-friendly fiscal strategies. The sizeable fiscal effort undertaken so far and the deterioration of the economic situation, especially in the most vulnerable Member States, have allowed for a modulation of the consolidation strategy provided that they are backed by sufficiently ambitious reform programmes.

Second, we continue the momentum on structural reforms for competitiveness, growth and jobs. We have taken a number of decisive actions to address the critical issue of youth unemployment. In June 2013, EU Heads of State and Government endorsed a comprehensive plan to combat youth unemployment. The plan includes speeding up the implementation of the Youth Employment Initiative and the Youth Guarantee scheme, as well as increasing youth mobility and the involvement of social partners.

Third, continuing the repair of the banking system, and addressing financial fragmentation is a top priority. The ECB will perform a balance sheet assessment before it will fully assume its role as supervisor under the Single Supervisory Mechanism. There will also be a new EU-wide bank stress test carried out by the European Banking Authority (EBA) in 2014. These exercises, followed by a recapitalisation of relevant banks, should allow for the necessary repair of bank balance sheets. This is crucial to allow banks to revive credit provision and thereby will form the basis for economic recovery. Regarding the latter, the European Council of 27-28 June endorsed an initiative to help restore lending to the real economy by leveraging resources from the EU budget with European Investment Bank lending. The SME Financing Initiative aims at combining different EU funds and the resources of the European Investment Bank, and national promotional banks as appropriate, to provide a boost to SME lending in the order of EUR 55 billion to EUR 100 billion, starting in 2014. The central elements of the initiative are an SME loan guarantee and a securitisation programme, which would provide beneficiary banks with capital relief and liquidity, thus enabling them to expand their SME lending.

Fourth, we are also forcefully continuing our reforms to strengthen the EMU. Banking union is the critical means to overcome the fragmentation of the EU single market for financial services, to ensure the economic recovery by restoring confidence in the banking sector, and to improve the functioning of the Economic and Monetary Union. The advanced work on a single set of harmonised rules lays the foundation for the banking union. The EU implementation of Basel III (CRR/CRDIV) will be applicable as from 1 January 2014. Negotiations on the Bank Recovery and Resolution Directive are progressing well and the objective is to reach a political agreement on this proposal and on the Directive on Deposit Guarantee Schemes by the end of this year. It is important, and we are therefore working diligently to ensure that the EU delivers quickly on all elements of the Banking Union. We have already reached a political agreement on the first element of the banking union, the Single Supervisory Mechanism. As a result of the vote taken in the European Parliament in September, the SSM is expected to enter into force shortly and be fully operational in the autumn of 2014, 12 months later. On 10 July 2013, the European Commission presented a proposal for a Single Resolution Mechanism for countries participating in the Single Supervisory Mechanism in order to complete the Banking Union with a resolution pillar. This is currently under discussion by the EU Council of Ministers and European Parliament with a view to reaching agreement in the Council by the end of the year so that it can be adopted before the end of the current parliamentary term, in line with the indications by the European Council of 28 June. Last but not least, the main features for direct recapitalisation by the European Stability Mechanism were agreed in June; this paves the way for establishing the new instrument shortly.

By reducing policy uncertainty, repairing the financial system, and creating new investment opportunities, all these actions will help reverse the negative feedback loop between confidence and growth, paving the way to robust medium-term growth.

While global financial stability has been significantly strengthened, we need to continue the necessary financial market reforms and maintain the framework for sustained and permanent international cooperation in this area. The EU sees three main priorities where further progress and effort are still needed: (i) Finalising the reforms necessary for a stable and resilient banking sector. This should include in particular the finalisation and implementation of the Basel III provisions in all G20 jurisdictions; (ii) Agreeing the policies needed to manage systemic risk wherever it originates in the financial system. This should comprise in particular the policies that should be applied to those financial institutions and infrastructures which may pose the greatest risks to the world economy; the measures that are needed in the event of a failure of these entities and to ensure that cross-border resolution also works; and the reforms needed to ensure that the risks associated with the shadow banking system are properly managed; and (iii) A commitment to on-going international cooperation to address outstanding cross-border issues, ensure the consistency of the financial reform and avoid the fragmentation of global financial markets. This should include the efforts to continue to overcome conflicts, inconsistencies, gaps and duplicative requirements globally in relation to OTC derivatives. In addition, global cooperation is also needed to ensure the effective convergence of international accounting standards; coordinating approaches to reform of financial benchmark setting; further reducing excessive reliance on credit rating agencies; implementing the global system of legal entity identifier; continuing to close data gaps; and fighting non-cooperative jurisdictions.

In the last year we have made further progress to increase the legitimacy, credibility and effectiveness of the International Monetary Fund. 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.

We consider that the ratification of the 2010 Quota and Governance Reform should be our priority. All 28 EU Member States have already fully ratified it. We encourage all IMF member countries that have not yet ratified it to do so expeditiously. The EU also reconfirms that it stands ready to continue constructive discussions on the quota formula and the 15th General Review of Quotas in order to reach an agreement by the agreed deadline of January 2014. We emphasize in this regard the January 2013 agreement by IMF members which states that all elements are interconnected and that we need to go forward by way of an integrated package. The integrated package implies that no decision can be taken in isolation. The main variables of the quota formula should remain both GDP and openness which best capture the role and mandate of the IMF.

The European Commission welcomes significant improvements in Fund surveillance in recent years, including the adoption of the Integrated Surveillance Decision and an institutional view on capital flows. The implementation of recent reforms should ensure progress in enhancing the effectiveness of Fund surveillance. Against this background, we look forward to the forthcoming Triennial Surveillance Review by the Fund with the envisaged objective of assessing effective implementation of the integrated surveillance framework and examining the consistency, clarity and focus of IMF policy advice. In this regard, we would like to emphasize the importance of an effective and comprehensive surveillance of monetary unions that should take proper account of the respective competences at EU Member States' and European Union level, as well as of internal and external interconnectedness.

The European Commission supports the regular conduct of 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.