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Chairman
EU Council of Economic and Finance Ministers

Statement by Minister for National Economy György MATOLCSY,
in his capacity as Chairman of the EU Council of Economic and Finance Ministers, at the IMFC Spring Meeting, Washington, D.C., April 16, 2011

1. I submit, in my capacity as Chairman of the EU Council of Economic and Finance Ministers, this statement which focuses notably on the world economy, in particular the outlook and policies for the EU, and on IMF policy issues.

I. ECONOMIC SITUATION AND OUTLOOK

2. The economic recovery in the EU continues to make headway. After a strong performance in the first half of 2010, real GDP growth in both the EU and the euro area slowed down in the second half of last year. The deceleration was expected and in line with a soft patch in global growth and trade, which reflected the withdrawal of stimulus measures and the fading of positive impulses from the inventory cycle. Nonetheless, the global economy, particularly the US and emerging market economies, proved more dynamic in the fourth quarter than expected in the 2010 autumn forecast, in particular thanks to the strengthening of (private) domestic growth drivers. This provided a positive offsetting impulse to the adverse weather effects observed in the final part of the year in some Member States.

3. Looking ahead, EU GDP growth in 2011 is set to gather pace, despite lingering vulnerabilities in financial markets. This outlook is supported, inter alia, by better prospects for the global economy and by upbeat EU business sentiment. The former owes mainly to a better outlook for the US, while growth in major emerging market economies continues to be buoyant. The latter generally points to economic activity gathering pace going forward and shows signs that the recovery is also broadening across sectors. Moreover, developments in profitability, order books, lending to households, saving ratio also point to a gradually firming pace of domestic activity. However, developments remain uneven across member states. The encouraging progress in economic sentiment stands in contrast with the tensions observed in some sovereign-bond markets in the EU since autumn.

4. Amid still high uncertainty on the global recovery, risks to the EU economic growth outlook at the current juncture appear broadly balanced for 2011. The main downside risks are on the external side and related to the events in the MENA (Middle East and North Africa) region (and their impact on commodity prices and especially on oil prices, which are increasing despite the spare capacity in OPEC countries) and Japan (and their impact on confidence).

5. The resurfacing of global imbalances, a major medium-term challenge for global macro-economic and financial stability, weighs on the outlook. Global imbalances narrowed considerably during the crisis but remain large and are widening again. This issue is part and parcel of the G20 Framework for Strong, Sustainable and Balanced Growth and the Action Plan adopted in Seoul. All the major economies should do their part, otherwise previous efforts risk being erased by possible future crises. The euro area dimension needs to be duly taken into account when assessing global imbalances.

6. Financial markets and institutions have over the past months continued to stabilise. This trend was supported by signs of an ongoing and broadening global economic recovery. In particular, the financial situation of the EU banking sector has overall improved, risk spreads have slightly narrowed and financial asset prices increased. However, more recently, events in the MENA region, and their effects on global commodity prices, and the earthquake in Japan were again sources of instability in financial markets at large. In addition, the evolution in euro-area sovereign bond markets, driven by investor concerns about public debt sustainability in several euro-area Member States, has continued to weigh on the EU financial sector. The main risk to macro-financial stability continues to be the situation in euro-area sovereign bond markets.

7. With regard to price developments, euro area annual HICP inflation was 2.4% in February 2011. The increase in inflation rates in early 2011 largely reflects higher commodity prices. Pressure stemming from the sharp increases in energy and food prices is also discernible in the earlier stages of the production process. Inflation is seen to moderate again below 2% in 2012 but such projections do not take into account the most recent oil price increases and assume continued moderate wage and price-setting behaviour.

8. Risks to the medium-term outlook for price developments are on the upside. They relate, in particular, to second-round effects, to higher increases in energy and non-energy commodity prices—a risk that may be exacerbated by recent events in Japan and MENA countries. Furthermore, increases in indirect taxes and administered prices may be greater than currently assumed, owing to the need for fiscal consolidation in the coming years. Finally, risks also relate to stronger than expected domestic price pressures in the context of the ongoing recovery in activity.

Policy Developments

9. Since the Autumn 2010 Meetings, the EU has taken further determined action to safeguard financial stability and has put in place additional mechanisms that are at hand to address crises when they occur.

a) Macroeconomic and structural policies

10. Fiscal prudence is important, not only in order to address the significant long-term challenge of ageing, but also and even more urgently in the light of existing market concerns about public finance sustainability. Therefore ambitious fiscal consolidation is required, beyond the withdrawal of the stimulus measures which were necessary to tackle the recent crisis, in order to halt and eventually reverse debt accumulation and restore sound budgetary positions. All EU Member States are committed to start consolidation in 2011 at the latest. In several Member States, however, consolidation has been ongoing since 2010 or even earlier. That consolidation should remain differentiated across countries as regards timing, size and accompanying policies. In countries with particularly severe fiscal challenges, in particular when facing financial stress, consolidation should be frontloaded and indeed numerous Member States have accelerated the implementation of their consolidation plans. In general, annual structural fiscal adjustments should go well beyond 0.5% of GDP. Consolidation

should be growth-friendly and hence combined with the implementation of structural reforms of pensions, healthcare and labour markets aiming at increasing potential growth.

11. The Stability and Growth Pact, to be strengthened by the forthcoming adoption of the legislative package to enhance economic governance, remains the appropriate framework for coordinating fiscal policies of EU Member States. In particular, for Member States subject to the excessive deficit procedure (EDP), the deficit targets and the structural adjustments should be fully consistent with a timely correction of the excessive deficits in line with existing Council recommendations and not lead to a back-loading of the necessary adjustment. Moreover, in the context of the newly started cycle of policy coordination called European semester, countries should present in their forthcoming Stability and Convergence Programmes concrete multi-annual consolidation plans including specific deficit, revenue and expenditure targets and the strategy envisaged to reach these targets. All Member States should keep the growth of expenditure net of discretionary revenue measures clearly below the medium-term rate of potential GDP growth until they have reached their medium-term budgetary objective (MTO), while prioritising sustainable growth-friendly expenditure and promoting efficiency of public spending. The Stability and Convergence Programmes should be based on cautious growth and revenue forecasts.

12. The EU has taken major initiatives for tackling structural weaknesses of the European economies. An urgent need for growth-enhancing measures was identified, to be implemented in a frontloaded manner. In summer 2010, EU leaders agreed on a ten year programme "Europe 2020", which sets out a vision for Europe's social market economy for the next decade. The new strategy aims at smart, sustainable and inclusive growth in Europe, making the European economy more resilient to shocks and securing jobs to people. A set of measurable and ambitious headline targets in the areas of labour market, R&D, innovation, education, energy efficiency and social cohesion has been agreed to help ensuring strong political ownership of national reform agendas. The Commission is putting forward horizontal initiatives ("flagships") to catalyse progress. Addressing the bottlenecks to growth timely in each Member State as well as in the EU as a whole would provide the EU a solid footing for coping with global challenges, also contributing to reach a strong, sustainable and balanced growth at a global level.

13. The EU has worked intensively to strengthen economic governance, in order to eliminate the deficiencies that were revealed during the crisis. The Union has agreed on a comprehensive approach to an enhanced and integrated surveillance of macro-financial challenges in the Member States. A particular emphasis is given to ex ante economic policy coordination, taking into account the interdependence of the European economies and the EU/euro area dimension. This would be achieved through the launch of a new annual cycle of policy coordination, called the "European Semester". The first European Semester was kicked off in the very beginning of 2011, with the presentation of the Commission's first Annual Growth Survey. The latter presents horizontal guidance on the policies to carry out with a view to responding to the main economic challenges in Europe, in terms of fiscal consolidation, correction of macro-structural imbalances and job- and growth-enhancing policies (in line with the "Europe 2020" strategy).

14. To underpin the reinforcement of economic governance in the EU and the euro area, the Commission also adopted a comprehensive package of six legislative proposals in September 2010. The legislation is foreseen to be agreed between the Council and the Parliament by summer 2011. The proposals aim at further strengthening the Stability and the Growth Pact (SGP) and introducing a system to prevent and correct macro-economic imbalances. The new legislative elements for ensuring sound fiscal policies include the consideration of public expenditure growth and better surveillance regarding public debt developments, operationalising the Treaty-based debt criterion. The introduction of minimum requirements for national fiscal frameworks would enhance the rule-based footing of fiscal policy making. Macro-financial stability in the EU would be addressed by the regular surveillance of external and internal macro-economic imbalances of the Member States. An Excessive Imbalances Procedure (EIP) may be launched for Member States that experience imbalances of severe nature, with potential negative economic and financial spillovers or threatening the proper functioning of Economic and Monetary Union. The procedure would include policy recommendations by the Council setting out the nature and implications of the imbalances to ensure corrective action by the Member State concerned. The legislative package also provides for a strengthened enforcement mechanism for euro area Member States under both the SGP and EIP, including a system of early sanctions.

b) Financial market policies

15. The European Union is currently in the midst of an ambitious and intensive programme of regulatory reform for the financial sector. The financial market reform package covers several primary areas: better and more integrated supervision and regulation for financial services, greater consumer and investor protection, and the development of appropriate mechanisms for crisis management and resolution to minimise both the cost to taxpayers and disruptions to the financial system and the economy as a whole. These objectives should be achieved while at the same time fostering and deepening the single market for financial services as well as increasing financial stability on a long-term and global basis.

16. The establishment, as of 1 January 2011, of the new supervisory framework – made up of the European Systemic Risk Board (ESRB) and the three European Supervisory Authorities – marked a major step in the implementation of the EU's reform agenda. The EU continues to progress towards completing work on legislative proposals related to financial institutions and markets. The financial reform seeks to implement, among other things, appropriate regulation for the banking sector, alternative investment funds, credit rating agencies, and OTC derivatives markets – as well as new rules for short-selling and CDS. The new Basel agreements will be transposed in EU law and the capital requirement rules for the insurance sector will be modernised via the Solvency II legislative framework. Furthermore, the EU is reviewing Community law with an aim to harmonise regulation for investment services; this entails revisions to the Markets in Financial Instruments and Market Abuse Directives and launching proposals on a Securities Law Directive, Central Securities Depositories and corporate governance.

17. Policy makers also continue to make progress with respect to financial market repair, inter alia by accelerating the restructuring and return to viability of banks and financial

institutions where needed. This is crucial if the sector is to contribute to the economic recovery. As banks gradually proceed with restructuring, the 2011 EU-wide stress test exercise, coordinated by the newly established European Banking Authority (EBA), will provide insights and examine the health and resilience of the EU banking sector. This exercise, the results of which will be published this summer, is expected to be more severe and more consistent in its application across individual banks compared to previous year's exercise, thanks to a rigorous peer review process carried out by the EBA with the participation of national supervisors, the European Central bank and the ESRB and the Commission. The degree of disclosure will also be enhanced. Among other new elements, this latest round of stress tests will also include an assumed increase in the cost of funding for banks and its corresponding implications for their profitability.

18. The European Council has agreed on the need for euro-area Member States to establish a permanent stability mechanism: the European Stability Mechanism (ESM). The ESM will be activated by mutual agreement[1], if indispensable to safeguarding the financial stability of the euro area as a whole. The ESM will assume the role of the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM) in providing external financial assistance to euro-area Member States after June 2013. Access to ESM financial assistance will be provided on the basis of strict policy conditionality under a macro-economic adjustment programme and a rigorous analysis of public-debt sustainability, which will be conducted by the Commission together with the IMF and in liaison with the ECB. An adequate and proportionate form of private sector involvement will be expected on a case-by-case basis where financial assistance is received by the beneficiary State. The nature and extent of this involvement will be determined on a case-by-case and will depend on the outcome of the debt sustainability analysis, in line with IMF practices, and on potential implications for euro-area financial stability. The ESM will have an effective lending capacity of € 500 billion. The ESM will seek to supplement its lending capacity through the participation of the IMF in financial assistance operations, while non-euro area Member States may also participate on an ad hoc basis. Until entry into force of the ESM the Heads of State or Government of the euro area have decided that the agreed lending capacity of EUR 440 billion of the EFSF will be made fully effective. The lending rates of the EFSF will be lowered to better take into account the debt sustainability of recipient countries, while remaining above the funding costs of the facility, with an adequate mark up for risk and in line with IMF pricing principles. The same principles will apply to the ESM. The EFSF and ESM will also have the possibility, "as an exception," to intervene in primary debt markets, on the basis of strict conditionality via a macro-economic adjustment programme. It has also been agreed to extend the average maturity of the euro-area Member States loans to Greece to 7.5 years and to reduce the lending rate of the official financial assistance to Greece by 100 basis points.

c) Contributing to a more favourable international environment

[1] A decision taken by mutual agreement is a decision taken by unanimity of the Member States participating to the vote, i.e. abstentions do not prevent the decision from being adopted.

19. There is a need to re-affirm that it is in our mutual interest to support trade, and to avoid competitive devaluations and anticompetitive measures. In this respect, implementing the G20 commitments not to impose new trade and investment restrictions and not to create new subsidies to exports is essential. The lack of progress on the Doha Development Round bodes ill in this respect. All types of protectionist measures should be rejected ("standstill commitment"). We support an ambitious and balanced conclusion of the Doha Round this year.

II. IMF POLICY ISSUES

20. EU Member States strongly support the Fund's key role in facilitating international monetary and financial cooperation and appreciate the efforts undertaken by the IMF to assist members effectively in the current global economic and financial environment. Over the last few years, we have made considerable progress in modernising the Fund to make it better aligned with the changes in the world economy. The comprehensive quota and governance reforms in 2008 and 2010, the substantial increase in resources and improvements to the surveillance framework and lending toolkit, as well as the Fund's independent evaluation function, have been crucial to help increase the legitimacy, credibility and effectiveness of the IMF. However, the reform process needs to continue with a view to further improve the Fund's mission, mandate and governance structure. We will contribute constructively in this process to ensure a stronger IMF, better equipped to promote global financial stability and growth and to address the challenges of today's international monetary and financial system.

Surveillance

21. Surveillance is the Fund's key tool to support macroeconomic and financial stability at the global, regional and individual country level. In addition, surveillance will play an important role in the context of the reform of the International Monetary System, and shape the debate on the Fund's Mandate more generally. Against this background, the IMF should make every effort to further improve its expertise in this field.

22. EU Member States acknowledge that the IMF has already taken several steps to strengthen surveillance since 2008. We agree that bilateral surveillance must continue to be one of the main pillars of the IMF's surveillance framework. But we also strongly support a deepening and strengthening of the multilateral and regional aspects of surveillance and see scope in strengthening the engagement of the IMF with regional/country groups of policy makers. We welcome the recent increased focus on risk assessment and the multilateral perspective of surveillance. We also look forward to the forthcoming spillover reports for the five most systemically important economies/regions of the world, including the euro area and the UK.

23. We believe that the overall emphasis in the forthcoming 2011 Triennial Surveillance Review should be on options to improve traction on members' policies with a view to strengthening the IMF's crisis prevention role, as also highlighted in the recent IEO recommendations. In this context, we reiterate that greater willingness by members to implement Fund’s policy advice is required. In addition, it would be useful if the risks stemming from the private sector and non-regulated parts of the financial sector could also

find reflection in the upcoming review. The inter linkages between the Fund's work on surveillance and other relevant on-going processes, including on the Framework for Growth and the International Monetary System discussion in the G20-context, and in the FSB also need to be taken into account. EU Member States welcome the proposed review of the legal framework on surveillance, but further work is needed on possible options for reform, including an assessment of the 2007 bilateral surveillance decision, a possible multilateral surveillance decision or an amendment of the Articles of Agreement.

Capital flows

24. Capital flows contribute to growth and the efficient allocation of capital, but may have destabilising effects in case of extreme volatility and sudden stops. There are thus strong merits in providing a cooperative solution on this issue. Given that the Fund has a unique mandate to oversee the stability of the international monetary system, we should call upon the IMF to take a more active role in monitoring global capital flows with the aim of enhancing global stability. We urge the IMF to work on a better understanding of the main determinants and drivers of international capital flows, identifying appropriate domestic responses and to develop in a first step an own institutional view towards the capital account and capital account policies.

25. EU Member States support the development of guidelines/a framework, covering both source and recipient countries, to provide countries with guidance by the IMF on policies to deal with capital flows. The use of guidelines should be part of a comprehensive exercise that emphasizes the importance of macroeconomic and prudential policies and structural measures as primary capital flow management tools. Over time, we could consider integrating such guidelines in the IMF's bilateral, regional and multilateral surveillance framework. At a later stage this could also call for an amendment to the Articles of Agreement if deemed necessary.

26. EU Member States stress that appropriate macroeconomic and prudential policies should always be the first line of defence against excessive and volatile capital flows. We believe that the overarching objective should be for countries to aim at a carefully sequenced liberalisation of their capital accounts in order for financial integration to be more in line with real integration whilst safeguarding financial stability. We recognize that under specific circumstances, some temporary capital controls may be necessary to shelter economies from sudden swings in capital flows, or, excessive capital flows. If they are used, temporary controls should be last resort, strictly targeted, transparent and have a clearly communicated exit strategy. Countries considering capital controls should also take into account the multilateral repercussions and potential external spillovers on other countries/groups of countries, and the feedback loop if these countries take retaliatory measures. Consideration and implementation of capital controls should be undertaken in a manner allowing for multilateral and regional discussion.

IMF resources

27. Over the past two years the financial resources of the IMF have substantially increased. We welcome the now full ratification of the 2008 quota and voice reform as well

as the further reforms agreed in 2010. Together, these reforms will secure the IMF's status as a quota-based institution, with sufficient resources to support members' needs. EU Member States encourage the early start of national procedures to ratify the 2010 reform.

28. EU Member States welcome that the NAB has become effective. All EU NAB participants have consented to the reformed and increased NAB and to the establishment of an activation period under the NAB for a period of six months, with an amount of SDR 211 billion. We urge those IMF members that have not yet ratified the New Arrangements to Borrow (NAB) to do so urgently. EU Member States also stand ready to voluntarily maintain temporarily their bilateral loan agreements to finance drawings under existing Fund arrangements, provided that a fair burden sharing is ensured with the rest of the participants. We invite others with bilateral loan and note purchase agreements to do the same to help guaranteeing the liquidity of the Fund.

Global liquidity and reserves

29. Further work on reserve adequacy and the drivers of reserve accumulation would also be useful. We agree that precautionary reserves are only one part of a country's defence against shocks, and that a sound macroeconomic and prudential policy framework is more important than reserves in limiting country vulnerability. EU Member states welcome the analysis carried out by the Fund on defining new quantitative metrics of reserve adequacy. Such metrics are a useful additional tool for discussion with countries in the context of IMF's surveillance, and can contribute to the broader discussion on large and persistent global imbalances.

The role of SDR

30. We welcome the opportunity to discuss the role of the Special Drawing Rights (SDRs) in the International Monetary System. The discussion on the SDR should be seen as one of the elements in the broader debate on how to improve the functioning of the IMS. If a certain number of steps were taken – which however confront significant practical, political and legal hurdles – the SDR could possibly contribute to a certain extent to improving the functioning of the system. As the SDR is not itself a currency, any possible initiative requires cooperation by the IMF members backing the SDR system. EU Member States consider that actions regarding the SDR need to adhere to the concept of the long-term global need for liquidity to supplement existing reserves, which is stipulated in the IMF Articles of Agreement as a precondition for SDR allocations.

31. EU Member States could agree to explore in more depth whether a limited number of currencies of systemically important countries should over time be added to the SDR basket to reflect global economic realities. This should follow clear and transparent criteria and entail adequate preconditions for the currencies concerned to ensure that the stability of the basket is safeguarded. We are also open to discuss the possible costs and benefits of SDR exchange rate pegs and from issuing SDR denominated debt as a possible way to reduce balance sheet risks. It would also need to be assessed how allocating SDRs on a contingent

basis for the use only in case of systemic shocks or financial distress could offer benefits over and above existing Fund instruments. However, enhancing the role of the SDR cannot on its own provide a remedy to all the ills of the IMS and providing SDRs on a regular basis might induce countries to postpone necessary adjustments.

Lending framework

32. EU Member States welcome the substantial progress made in enhancing the financial instruments of the IMF, including last year's changes to the Flexible Credit Line (FCL) and establishment of the Precautionary Credit Line (PCL). Further work should include the assessment on our capacity to cope with systemic crisis and the exploration of ways to improve collaboration between regional arrangements and the IMF. In Europe, our collaboration with the IMF is already well advanced as reflected in our joint IMF-EU programmes. We appreciate working together with the IMF when designing the programmes and believe that we could share our experience with other regions. Moreover, we look forward to the review of conditionality in and design of IMF-supported programs, which will give us insight into the effects of the recent changes and developments in the Fund’s lending toolkit.

Broader governance

33. EU Member States consider that the 2010 broader governance reforms, including the commitment from advanced European countries to consolidate their representation in the Executive Board, represent an important step to ensure an appropriate governance structure by further reflecting present economic realities and thus enhancing the voice and representation of emerging and developing countries, including the poorest. However, for the institution to be well-functioning and fully efficient, and to enhance further the IMF's legitimacy, progress is required also on other reform elements such as the involvement of ministers and central bank governors.

34. EU Member States welcome the election of the new IMFC chairman. We continue to believe that greater ministerial engagement and increased accountability of the Fund, either through a strengthened and decision-making IMFC or an "International Monetary and Financial Board" (IMFB), is essential to the institution’s effectiveness. The Fund would benefit from a greater political traction and ownership by its members. We also reiterate that the criteria and the procedure for the selection process of the IMF Managing Director should be part of a broader reform including top management from other international financial institutions including in particular the World Bank, and that the election should follow an open, transparent and merit-based process, irrespective of nationality and gender. Finally, we encourage the IMF to make additional progress towards improving staff diversity.

Role of the IMF in low-income countries (LICs)

35. We support the IMF's efforts to support low-income countries (LICs), including the modifications to the Fund's lending facilities and financing framework in 2010 as well as the on-going work on assessing the vulnerabilities and risks in LICs stemming from changes in the global economic environment. We agree that the proposed Vulnerability Exercise for

LICs with the establishment of a systematic framework with redefined and additional quantitative tools could add value to the existing surveillance toolkit. Compared to emerging and advanced countries, LICs are particularly vulnerable to exogenous shocks such as sharp swings in commodity prices or trade volumes, volatile capital flows, and natural disasters, and negative external shocks often have important consequences for output and growth. EU Member States look forward also to a discussion on options for the future of the Heavily Indebted Poor Countries Initiative (HIPC). We agree that there is scope for streamlining the reporting on progress under the HIPC Initiative and for intensifying cross-country monitoring of, and reporting on, debt vulnerabilities in LICs and encourage emerging creditors to join and strengthen multilateral coordination in initiatives to alleviate the problems of LICs.