



International Monetary and Financial Committee

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On behalf of the European Commission

**Statement of Commissioner Joaquin Almunia to the
International Monetary and Financial Committee,
on behalf of the European Commission**

Singapore, 17 September 2006

The **global economy** continues to expand at a robust, if somewhat slower pace. World growth has become better balanced.

The strong rise in **oil prices** has so far been absorbed relatively well. Still, the continued tightness of the oil market in a context of robust oil demand and heightened supply concerns poses a risk to global growth. As oil prices are likely to remain high for some years to come, the Commission encourages oil producing countries to improve their investment climate in order to facilitate an expansion of their supply capacity. Consumer countries need to rein in demand by increasing energy efficiency and making use of innovative technologies and new sources of energy. The work initiated last spring at the European level to develop a common energy policy for Europe continues, and a prioritised Action Plan is being prepared. The Commission welcomes the progress made in improve the transparency of oil markets, and encourages further efforts.

In the context of the positive global outlook, euro area and EU **economic prospects** have improved significantly. GDP growth accelerated to a rate clearly above potential in the first half of 2006. The Commission expects a continuation of this trend in both 2006 and in 2007, with domestic demand gradually gaining momentum. Investment, in particular, has been growing at a brisk pace and private consumption also shows signs of an acceleration, underpinned by improvements in

the labour market. In its recently released interim forecast, the European Commission revised up the growth outlook for 2006 to 2.5% in the euro area and to 2.7% in the EU.

Two years after joining the EU, most of the ten new EU Member States are continuing their catching-up process in terms of income and employment by maintaining high growth momentum. In particular, their domestic demand supports the expansion, fuelled by strong credit growth. However, this has also led in a number of countries to widening current account deficits, which deserve attention in order to preserve macroeconomic stability.

In January 2007, Slovenia will become the first of the new EU Member States to adopt the euro. This is a major achievement for Slovenia, which has a strong track record of sound policies. It also opens an important new chapter in European monetary integration. Over the coming years, other new Member States are set to join the euro area, provided that they have achieved a high degree of sustainable convergence.

Regarding **price developments** in the euro area, headline HICP inflation has remained above 2%, largely as a result of high energy prices. Gradual increases of producer prices have become visible in recent months. However, inflation excluding energy and unprocessed food (core inflation) remains well contained, pointing to little pass-through of energy price rises to non-energy consumer prices so far. Inflation expectations, while accelerating somewhat, continue to be well anchored.

Given the improved growth prospects, an adjustment of the euro-area's macroeconomic policy mix is warranted. The ECB has raised its main policy rate in four steps of 25 basis points since December last year.

Nonetheless, nominal and real interest rates remain low, thereby continuing to support the economic momentum in the euro area.

Although progress has been made towards securing more **sustainable public finances**, including through pension reforms, ageing populations will impose pressures on public finances in the years to come. The first year's experience with the revised **Stability and Growth Pact (SPG)**, the EU fiscal policy framework, is overall very positive. Budgetary consolidation in the EU has resumed. In structural terms, the EU-25 budget balance improved by 0.8% of GDP in 2005. Such an outcome was partly due to better than expected government revenues, but was also the result of measures taken, especially in countries in excessive deficit, i.e. with deficits above 3% of GDP. After the reform of the SGP, the procedures to correct these deficits have been implemented in a smooth way, reflecting increased ownership and a constructive dialogue at the EU level, although relatively large budgetary adjustments were requested in some cases. Looking ahead, advantage needs to be taken of the positive economic outlook to step up consolidation efforts. This would set the conditions for an appropriate policy mix, creating room for manoeuvre in downturns and contributing to reducing debt levels before the budgetary effects of ageing set in.

The **US economy** has started to grow at a somewhat slower pace, with the downturn in the housing sector acting as a drag on the economy. The rise in core inflation requires a close watch. While the current account deficit remains unsustainably high, the fiscal deficit has narrowed considerably thanks to fast-rising tax revenues. It is, nevertheless, still necessary to adjust fiscal policy to set public finances on a prudent medium-term course and to raise national savings.

The **Japanese economy** continues to expand vigorously with domestic components remaining the main drivers of GDP growth. The economy is also gradually escaping from deflation, allowing for a normalisation of monetary conditions. With a rapidly ageing population and a heavy debt burden, fiscal consolidation is now becoming the key policy challenge.

China's outstanding economic performance has turned it into a growth engine for the world economy. However, a more balanced growth pattern would require rapid progress in improving the social welfare and education system and in further reforming the financial system to ease credit access of both households and small and medium enterprises. Greater exchange rate flexibility would also contribute to curbing China's large current account surplus.

Developments in **emerging Asia** are also positive, with solid economic growth helping to improve the living standards of its population. Overall, Asia is today the fastest growing region in the world, contributing to almost 50% of world growth. Looking ahead, the key policy issue is to further adjust to the accelerating pace of globalisation, with its wide-ranging impact on production patterns, trade linkages, employment opportunities and financial flows. Reforms aiming at reducing domestic vulnerabilities and increasing the flexibility and the competitiveness of the economy need to be continued. At the same time, Asia, with its increasing economic strength, also needs to accept its responsibilities to help to address global challenges.

Global current account imbalances continue to pose a risk for the world economy, even though a smooth adjustment remains the most likely scenario, provided they are addressed properly through domestic macroeconomic and structural policies, since domestic imbalances are

the main source of current account imbalances. Tackling these weaknesses in a determined way is in each region's own best interest. By contrast, the consequences of failure to implement the necessary measures could well be felt at the global level.

In this context, the European Commission welcomes the new IMF instrument of **multilateral consultations on global imbalances**. This exercise can help refining the consensus on the necessary policies to reduce the imbalances and facilitate their implementation. Appropriate measures in the countries with the largest deficits and surpluses will have the greatest direct impact on reducing current account imbalances.

Europe features only a small current account deficit. Nevertheless we are ready to contribute to the necessary adjustment. In this context, the EU is pressing ahead with, and strengthening, its **Lisbon Strategy** of structural reforms. In doing so, the EU primarily responds to the need to improve its own economic perspectives. But by fostering Europe's economic growth potential, the implementation of the Lisbon agenda will also contribute to better balancing global growth and facilitate the adjustment of global imbalances. Reforms focus on removing the remaining obstacles to the development of a single market, enhancing the quality of labour markets policies, improving incentives to start-up and develop businesses, addressing long-term problems of environmental sustainability, and improving conditions for R&D and innovation. On the basis of implementation reports submitted by EU member states, the Commission is now assessing the implementation progress and providing advice on how to accelerate structural reforms and stimulate European competitiveness. A further positive boost to competitiveness will come from additional liberalisation of services, which is expected to be adopted by the European Parliament later in

2006. The legislation will help to create more growth and jobs in the EU by freeing up cross-border trade and investment in services.

Financial integration is also a key objective under the *Lisbon strategy*, as an integrated and efficient financial sector will raise the growth potential of the EU economy by improving the allocation of capital, enhancing productivity and providing wider opportunities for risk sharing. With the Financial Service Action Plan to complete a common EU regulatory framework now adopted at the EU stage, the financial integration process has entered a new phase. The Commission has identified priority actions for the coming five years. The main focus will be on consolidation with the timely and consistent transposition of EU legislation into national laws and enforcement of those laws.

The EU continues to implement its **neighbourhood policy** to strengthen its relations with neighbouring countries to the east and south. Deeper political cooperation and economic integration are at the core of this process. The policy seeks to support partners' own political, economic and social reform efforts and the long-term process of institution-building. Country-specific action plans define short and medium-term reform priorities. The Commission will issue later this year progress reports on the implementation of reforms in each country.

Eradicating world poverty and achieving the **Millennium Development Goals** (MDGs) remains the landmark of EU development policy, as agreed last year in the "European Consensus on Development". These challenging objectives require a parallel increase in the quantity and the quality of aid. EU aid volumes in 2006 are expected to be above the target we set ourselves and the EU is on track to achieve the 0.56% ODA/GNI target set for 2010. The EU has agreed on an action plan to

put into effect the Paris Declaration on aid effectiveness. It includes pragmatic deliverables such as a framework for joint multi-annual programming, steps towards a better division of labour between the EU and Member States and an increased use of budget support as aid modality. Since focusing on Africa is essential in order to achieve the MDGs, the EU is implementing its EU-Africa Strategy. In this context, the Commission proposed an "EU-Africa Partnership on Infrastructure" for trans-national infrastructure projects in the areas of transport, energy, water, and information technology. A new EU Infrastructure Trust Fund was also set up to help finance infrastructure projects in Africa. The Commission recently underlined the crucial importance of good governance for development which will be reflected in the country allocations of the European Development Fund from 2008 onwards.

The Commission welcomes and supports the Board of Governors resolution on the reform of **quotas and voice** at the IMF. The initial round of ad-hoc quota increases will address the legitimate claims of the most underrepresented countries in the IMF, while more fundamental issues, including the increase in basic votes, are now on a clear and ambitious time track. A comprehensive reform will enhance the legitimacy, credibility and governance of the IMF. **Surveillance** remains central to the IMF's role in promoting sound economic policies and financial stability. To this end, surveillance needs to be made more effective by re-focussing its objectives.

An open rules-based multilateral trading system is a necessary precondition for higher and sustained rates of economic growth. In this respect, the Commission deeply regrets the suspension of the **Doha Development Agenda** (DDA) earlier this year. The costs that arise as a result of the suspension of the negotiations are high. All WTO Members

must be ready to restart the negotiation, on the basis of existing offers, as soon as circumstances permit. The DDA remains a central priority of EU trade policy, and the EU is fully committed to open markets, progressive trade liberalization and multilateral rules, and to a successful completion of the talks. The EU will continue to strive for a result that will deliver real cuts in tariffs and subsidies and will foster new trade flows, as part of a deal that should bring benefits to all WTO Members. In the meantime, some of the work on a number of issues which are relevant to development should continue. The Commission strongly welcomes the approval of the report of the Aid for Trade Task Force despite the suspension of the DDA negotiations. This illustrates the importance of aid for trade in its own right. The EU is ready to work with partners in the WTO, and in particular with beneficiary countries, to implement the recommendations of the report.