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Statement by Joaquin Almunia
Commissioner, European Commission

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to the International Monetary and Financial Committee,
on behalf of the European Commission

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This meeting is taking place against the background of a still **resilient global economy** with emerging markets contributing significantly to global growth. However, the risks for the global economy are now clearly tilted to the downside. It is yet uncertain how persistent the US slowdown will prove. Notwithstanding the signs of normalisation recently observed in financial markets, there is still potential for a broader impact of the financial crisis on the real economy. Further risks stem from additional increases in oil and commodity prices as well as disorderly adjustment in exchange rates owing to global imbalances.

In this context, the **US economy** continued to expand at a healthy pace in 2006 and the first half of 2007. After the strong acceleration of GDP growth in the **EU** in 2006 (3%), thus well above potential, the pace of economic activity started to normalise in the first half of 2007. However, taking into account the volatility of quarterly figures and some specific factors, which affected economic activity in the first quarter (such as weather conditions), the economy of the EU maintained considerable dynamism, with quarter-on-quarter GDP growth at 0.6% on average during this period (2.4% annualised). The European Commission assumes that the turbulence in the financial markets will peter out and, on the back of sound fundamentals and a still favourable global environment, expects the positive outlook for the EU economy to be largely maintained during the second half of the year. Overall, GDP growth in 2007 is currently projected at 2.8%, only a marginal downward revision compared to the spring forecast (2.9%). However, downside risks to the economic outlook have increased, particularly in view of the uncertainty created by tensions in financial markets, ongoing adjustment in housing prices in some Member States and concerns about further increases in oil and commodity prices.

Given robust GDP growth in the euro area and predominantly upward inflation risks, the ECB continued to withdraw **monetary policy** stimulus throughout the summer of 2007. However, the financial market turmoil has increased the level of uncertainty considerably. The ECB eventually decided to keep interest rates unchanged this summer. While central forecasts for growth and inflation have been revised only slightly, downward risks to growth have intensified. Meanwhile, euro area **inflation** has increased to above 2% in September, mainly due to base effects from energy prices. Inflation expectations continue to be well anchored, but risks to price stability are still predominantly on the upside. Money and credit growth have also remained strong. Yet there are indications that the financial market turmoil has caused a significant tightening of credit standards for households, and especially for non-financial companies.

The **current financial crisis** provides clear evidence of the complexity and interconnectivity of the international financial system. In response, EU Finance Ministers have identified a preliminary set of key issues for the implementation of a roadmap. This roadmap addresses issues of transparency, valuations and the accounting treatment of assets, the strengthening of the prudential framework, of risk management and supervision in the financial sector and how to improve the functioning of financial markets in general, including the role of credit agencies. Europe has been the first to respond in this way. The Commission believes that many of these actions will have to be addressed in a global context in a coordinated way. Bodies such as the Financial Stability Forum, the Basel Committee on Banking Supervision and the Joint Forum on Financial Conglomerates will be used in implementing the roadmap.

Developments in **global current account imbalances** have been mixed since the Spring meetings. While the US current account deficit has declined, current account surpluses in China, Japan and emerging Asian economies have continued to rise. Current account surpluses of the oil exporting economies in the Middle East are also likely to increase further. The euro-area's external position, in contrast, is in balance. All countries involved in the multilateral consultations have taken steps in line with the agreed strategy over the past year. This is a positive development. However, the progress made to date has been insufficient and global imbalances are far from having been sufficiently addressed. Our priorities in Europe – which are also desirable from a multilateral perspective – centre on further reforms in product, labour, and financial markets. These reforms will raise the euro area's potential growth rate, lift domestic income, and increase the euro area's capacity to absorb imports from other parts of the world. The euro area's reform efforts will ultimately make an important contribution towards a global rebalancing of demand growth. Other actors must now follow suit and implement the agreed IMFC strategy.

Exchange rates should reflect economic fundamentals. Excess volatility and disorderly movements in exchange rates are undesirable for economic growth. The recent financial turmoil, which was accompanied by increased foreign exchange market volatility, points to the risk of exchange rate overshooting. Euro area authorities have noted with great attention that the US authorities have reaffirmed that a strong dollar is in the interest of the US economy. The Japanese economy is on a sustainable recovery path. These developments should be recognized by market participants and be incorporated in their assessments of risks. Markets should be aware of the risks of one-way bets. In emerging economies with large and growing current account surpluses, especially China, it is desirable that their effective exchange rates move in the appropriate direction that will allow the necessary adjustments to occur.

Foreign exchange reserves of many emerging market economies have increased substantially. This has resulted in a rapid expansion of **sovereign wealth funds.** While the EU acknowledges the beneficial contribution these funds may provide, their potential growth raises concerns. For the European Union this is an important internal market issue that requires initiatives coordinated at European level. Furthermore, cooperation and a comprehensive dialogue between policy makers in the developed world and the emerging countries are needed to ensure that the public continue to support open markets.

Since the re-launch of the **Lisbon strategy** in 2005, progress towards meeting the objectives of higher growth and employment remain an overarching priority of European structural policies. As shown in the 2007 Annual Progress Report by the Commission important steps forward have been made on reinforcing financial sustainability. Pursuing this road and achieving sound finances in the medium- to long-term remains a significant challenge though. Weak competition in services, especially in energy networks, continues to hold Europe back. In labour markets, the growing consensus in favour of the "flexicurity" approach reform is an important step, although it has yet to be fully translated into action. This December, the Commission will present the 2008 Annual Progress Report and a proposal for an update of the strategy. One of the central elements of this update will be a revamped Community Lisbon programme that focuses on the most important actions that can be taken at EU level to raise growth and employment potential and on the need to complete the single market.

Financial integration is a key element of the EU reform strategy. An integrated and efficient financial sector raises the growth potential of the EU economy by improving the allocation of capital, enhancing productivity and providing wider opportunities for risk sharing. The process of EU financial integration is well under way, in particular in wholesale markets. Unfortunately, the integration of retail activities still lags behind, but nevertheless substantial progress has already been made and is likely to intensify in the years to come. Europe's priorities for action over the next five years were laid down in the White Paper presented by the European Commission. As the pace of cross-border consolidation among financial intermediaries has begun to accelerate, it is also of particular importance to ensure that the EU supervisory framework keeps pace with the changing economic and financial environment, so as to reap the full benefits of financial integration while safeguarding financial stability.

Euro area enlargement is progressing. Slovenia was the first of the new EU Member States to successfully join the euro area in January 2007. Cyprus and Malta will follow in January 2008, expanding the monetary union to fifteen members. Slovakia aspires to join in 2009 and its convergence assessment will be carried out in the course of Spring 2008. The Czech Republic, Hungary and Poland have postponed their decision on the eventual date for euro adoption and still need to make much progress with fiscal consolidation. For the Baltic countries, the initial target dates for euro adoption had to be abandoned due to higher-than-expected inflation. Euro area enlargement offers a unique opportunity both for prospective members and for the current member countries, which will benefit from the greater economic dynamism of the new entrants. Although the target dates for euro adoption have been delayed in some cases, the convergence process has value in itself as it targets macroeconomic stability and creates the foundation for sustainable long-term economic growth. In this context, the exchange rate mechanism **ERM II** provides a useful policy framework. By securing more stable exchange rate conditions, Member States can prepare for euro area membership and make progress towards real and nominal convergence.

Let me now turn to some key international challenges and the way the EU is addressing them.

The objectives of eradicating poverty and achieving the **Millennium Development Goals** continue to rank high on the EU agenda. The EU as the largest provider of Official Development Assistance (ODA) in the world is delivering on its ambitious aid promises. In 2006, the EU exceeded its self-set target of 0.39% of ODA relative GNI by disbursing a record high of € 48 billion of ODA, corresponding to 0.42% of its GNI. EU aid effectiveness has increased significantly through the adoption of an EU Code of Conduct on Complementarity and Division of Labour between EU donors and the increasing use of direct budget support as an aid modality. The EU continues to give high priority to Africa, which receives the majority of EU aid. The two continents will adopt the Joint EU-Africa Strategy at the end of the year at the EU-Africa Summit in Lisbon. The EU is in addition currently aiming to conclude a number of Economic Partnership Agreements with the African, Caribbean and Pacific regions. This will go hand-in-hand with an ambitious aid for trade strategy that will help developing countries to better benefit from the opportunities of globalisation.

The Commission appreciates that **the Doha Development Agenda** (DDA) negotiations have restarted on the basis of the proposals for draft modalities by the respective Chairs of the negotiating groups on Agriculture and Non Agricultural Market Access. This should allow the Chairs to take stock of the situation and prepare revised papers in the course of October, in view of an agreement on modalities in November. However, the window for concluding the DDA is narrowing. Much is at stake and a successful deal will have to be made on the basis of a balanced level of ambition requiring one final move in concert by all of the key players. The benefits of the DDA for the international economy are large, with the potential to create significant additional trade annually. These economic gains will, by far, outweigh the short term sacrifices that need to be made by the relevant players. Agreement on the DDA is also important politically. It will demonstrate that multilateral instruments are able to ensure that globalisation delivers for all.

Energy sustainability and climate change are areas where international co-operation is fundamental in order to achieve progress, and which remain priorities for EU policy. The European Council has adopted ambitious targets to underpin the overall energy policy objectives of increasing security of supply, ensuring competitiveness of the European Economy and promoting environmental sustainability. The European Commission is now working on a number of policy actions to let these ambitions turn into reality. These policies will set the EU on a path towards an energy efficient and low carbon economy. Due to the nature of climate change, it is vital that these efforts are matched by comparable progress at the global level. In this regard, the EU remains prepared to commit to reduce emissions by 30% by 2020 provided that other developed countries commit themselves to comparable emission reductions and economically more advanced developing countries to contributing adequately.

The **IMF** is the key multilateral institution guarding the functioning of the international monetary system. The Fund's legitimacy – and hence relevance – might be put at stake if in particular the quota reform fails to reach a satisfactory conclusion for all of the actors involved. This will require redressing the under-representation of dynamic and emerging market economies. The reform will also need to enhance the voice and participation of low income countries. In order to fulfil its mandate and perform its tasks the IMF requires a stable income stream in times when its lending activities are significantly reduced. The present proposals on a new IMF income model will help to ensure the financial sustainability of the institution. However, further progress on the expenditure side should accompany the income side. The Commission fully supports the IMF's new surveillance framework and encourages IMF members to assist the IMF in implementing this framework. The Commission welcomes the appointment of Mr. Dominique Strauss-Kahn as Managing Director and Mr. Tommaso Padoa-Schioppa as IMFC-Chairman.

The **fight against money laundering and the financing of terrorism** continues to be a high priority for the EU. In the EU, a robust anti-money laundering and counter-terrorism financing (AML/CTF) framework is in place, and continuous efforts are undertaken to increase its effectiveness further. The EU also provides technical assistance on AML/CFT to a number of third countries. In this context, the Commission welcomes and supports the regular assessments of member countries' strategies and measures by the IMF and the World Bank. This evaluation helps identify key areas where efforts and assistance need to be concentrated. Thanks to their expertise and global view, the IMF and World Bank continue to make valuable contributions to improve the coordination of this assistance