



# **International Monetary and Financial Committee**

Twenty-Fourth Meeting  
September 24, 2011

**Statement by Olli Rehn**  
Commissioner  
European Commission

**Statement of Commissioner Olli Rehn  
to the International Monetary and Financial Committee, 24<sup>th</sup> Meeting  
on behalf of the European Commission  
Washington, D.C., 24 September 2011**

The current outlook for the global economy is subject to high uncertainty and elevated risk aversion in the financial markets.

**GDP growth** in the EU and the euro area will remain subdued in the second half of the year, coming close to standstill at year-end. The soft patch predicted in our spring forecast is now likely to deepen but will not result in a double dip. Growth forecasts for the second half of the year have been revised down considerably, by ½ percentage point for both the euro area and the EU, compared to our spring forecast. Nevertheless, as a result of the stronger-than-expected performance in the first quarter, annual growth is still projected at 1.6% in the euro area and 1.7% in the EU. The current outlook is uncertain in view of the ongoing concerns about the sovereign debt crisis, the marked economic slowdown in the US, sharp increases in risk aversion and financial market volatility. The balance of risks to the interim forecast is to the downside.

The euro area **sovereign debt crisis** continues to weigh heavily on financial markets and has caused a significant increase in the overall risk perception. A major factor for the remaining uncertainty is the fear of spill-overs from Greece to other EU member states. The spill-overs from the unique situation in Greece are regrettable, because programme implementation in Ireland and Portugal is providing positive signals as confirmed by the latest review missions by the Commission, the IMF and the ECB. In both countries, governments have shown very strong commitments and have implemented adjustment measures swiftly, delivering on the agreed objectives. The troika intends to finish its current review to Greece by end of September. A positive assessment of compliance with the programme conditionality could allow for the 6th disbursement under the Greek Loan Facility Arrangement to take place later in October. The sovereign debt crisis had recently some spill-overs to Italy and Spain. Both countries are on track to reduce their debt levels and implement growth enhancing reforms. gyrations in financial market movements have prompted them to increase their efforts and they will implement new measures.

At their Summit on 21<sup>st</sup> July, Euro area leaders reaffirmed their commitment "to do whatever is needed to ensure the financial stability of the euro area as a whole and its Member States". The toolbox of the **financial assistance mechanisms** will be significantly widened and the lending rates will be reduced to a level de facto comparable to the borrowing rates of AAA countries. This will enhance the effectiveness of the EFSF and ESM and allow them to make a greater impact. Broad agreement has been reached on the guidelines and main features of the new instruments in the EFSF toolbox, including the possibility, on the basis of a precautionary programme, to intervene in the secondary markets and to finance recapitalisation of financial institutions through loans to governments. These powers will also be applicable to the ESM and be part of its toolbox. All tools will continue to be linked to appropriate conditionality. We are confident that all euro area Member States will ratify the agreement by end of September.

The European Commission also put forward legislative proposals to substantially strengthen **economic governance** in the European Union and in the euro area. While the first ten years of the euro have been a success, the crisis exposed a number of shortcomings in the policy framework. Windfalls accumulated during good times have not been sufficiently used to create room for manoeuvre when times turn bad.

A **comprehensive package of legislation** has been proposed to address these issues and the proposals are now very close to agreement. The package consists of three major building blocks: (i) a reinforcement of the Stability and Growth Pact and deeper fiscal policy coordination. In addition to deficits, much closer attention will be paid to debt developments. A clear benchmark will be introduced defining a satisfactory pace of debt reduction. There will also be minimum requirements for national fiscal frameworks ensuring delivery of budgetary obligations; (ii) a broadening of economic surveillance to include the prevention and correction of macroeconomic imbalances and competitiveness challenges. The Commission will monitor a scoreboard of economic and financial indicators and will carry out in-depth country analyses. Where necessary it will issue country-specific recommendations. If an imbalance is perceived to be of a serious nature, the Member State concerned would be placed in a so-called "excessive imbalances procedure" that would lead to the issuance of detailed policy recommendations and regular reporting from the Member States to the Council of Economics and Finance Ministers; (iii) the introduction of much stronger enforcement of economic surveillance through the use of financial sanctions. Progressive sanctions, including deposits and fines, kick in at an earlier stage of the surveillance process.

**Fiscal consolidation** remains a top priority for all countries in the EU, but the extent of necessary adjustments differs across the countries. With a view to keeping the balance between stabilisation and fiscal sustainability in mind, adherence to current fiscal consolidation plans seems appropriate if the slowdown remains limited. In this case, the projected fiscal stance would continue to be countercyclical. However, in the event of a more significant and protracted slowdown or even a contraction of economic activity the fiscal stance might become pro-cyclical. Under that condition, current fiscal adjustment plans might have to be reassessed, although on a country-by-country basis. Specifically, only countries with more fiscal space and on track to correct excessive deficits should primarily let automatic stabilisers work around the agreed path of structural fiscal adjustment. Additional policy responses should only be considered for these countries if growth collapses. Conversely, countries having accumulated significant adjustment gaps should step up consolidation efforts. Moreover, programme countries and those under close market scrutiny should strictly adhere to headline targets. In this regard, it is of the utmost importance that policy actions on the fiscal side fall within the commitments under the Stability and Growth Pact since adherence to its provisions is key to safeguard or rebuild fiscal credibility, especially in view of the ongoing turbulence in sovereign debt markets.

The EU is strongly committed to achieving necessary **financial reforms** and has made significant progress on a comprehensive package that incorporates several primary areas: better supervision, better regulation for financial services, greater consumer and investor protection and the development of appropriate mechanisms for crisis prevention, management and resolution in order to minimize the cost to taxpayers and disruptions to the financial system and the economy as a whole.

Importantly, the **ESRB and the new European Supervisory Authorities** for the banking, securities and insurance and pension systems started operating in January and are already tackling the critical issues in each of their respective domains. Furthermore, in late July, the European Commission proposed amendments to the Capital Requirement Directive (CRD-4) and, for the first time, introduced a regulation (CRR) translating the Basel III guidelines for banking prudential regulation into EU law.

Such reforms are needed if we are to **restore the financial sector** to full viability and regain market confidence. Meanwhile, a sound, stable, and more strongly capitalized financial sector will be better placed to provide credit to the rest of the economy including to households and small businesses. The 2011 EU-wide **bank stress test** provided incentives to increase capital ahead of

the test (around € 50 bn in the first four months of 2011 only). In the light of its results, more remedial plans (recapitalisation and restructuring) are expected in the next 6 to 9 months.

International cooperation will be critical to ensuring the longevity and sustainability of financial reforms and, therefore, of financial stability. International cooperation and coordination are also key to ensuring that global differences are minimized; eliminating opportunities for regulatory arbitrage; and maintaining a level playing field. The work of the FSB will continue to play an important role to that end. But global partners should also accelerate the implementation of their regulatory commitments, in particular the implementation of the Basel II and III agreements.

Euro area headline **inflation** came down from its peak of 2.8 percent in April 2011 to 2.5 percent in July. Likewise, core inflation (headline inflation excluding energy and unprocessed food) has also moderated from 1.8 percent in June to 1.5 percent in July. Inflation is expected to moderate further over the coming year and move below 2 percent. Risks to the outlook for price developments have become more balanced between weaker-than-expected growth and higher-than-assumed increases of commodity prices as well as revenue-based fiscal consolidation. Inflation expectations meanwhile remain well-anchored. At the Member State level, inflation differentials persist, with the higher bound of the range reflecting either short-term adjustment of indirect taxation in some countries or the more complete pass-through of energy and food prices in countries with a better cyclical position and labour market conditions.

The EU values the discussions in the IMF on **reforming the international monetary system**. Effective IMF surveillance is key for the efficient functioning of the international monetary system. As pointed out by the Triennial Surveillance Review, further progress is necessary to enhance the traction of surveillance; to develop a better analysis of interconnections, spillovers and external stability and to ensure more effective financial sector surveillance. The G20's Mutual Assessment Programmes will also play an important role in detecting and addressing imbalances that could spill over to the rest of the world. As we see a skewed international adjustment process as one of the main reasons for frictions in the IMS, we call for a progressive move towards market-determined exchange rates in systemic economies. Developing a roadmap to broaden the SDR basket, based on clear and transparent criteria, could support this. Further enhancements of the IMF's toolkit and general non-binding principles for the cooperation between Regional Financing Arrangements and the IMF would also strengthen the international monetary system. Strong and at times volatile capital flows raise justified concerns, as does the risk of sudden reversals. Thus sound domestic policies in recipient countries, including macroeconomic, prudential and exchange rate policies, are paramount to cushion the potential negative effects of large capital inflows. We therefore welcome the proposals made by the G20 for guidelines on capital flow management as a first step.