International Monetary and Financial Committee

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Statement by Mr. Almunia
European Commission

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

Washington, April 2006

Growth prospects for the **EU economies** in 2006 have improved. Most business sentiment indicators have recovered across the region towards the end of last year and the beginning of 2006, suggesting a strengthening of the recovery. Incoming data over the past weeks are pointing to an acceleration of growth in 2006 to around 2% in the euro area and to 2¼ % in the EU, in line with potential growth. This pick-up should be supported by the positive international environment. On the domestic side, risks seem quite balanced. The Commission expects a robust pick-up in investment expenditure, underpinned by improved corporate profitability and balance sheets, continued benign financing conditions and optimistic business sentiment. The upturn in consumption is expected to be more moderate, in line with a gradual improvement in the labour market. Although hourly labour costs have declined in the course of 2005, the response of labour markets to the economic cycle seems to be tempered.

The **new EU Member States** continue to benefit from accession and are enjoying strong growth. The decline in employment in these countries, which was linked to economic restructuring, appears to have stopped and labour markets have improved. Still, unemployment remains high and further reforms are necessary. In order to sustain the catching-up process, macroeconomic stability has to be preserved and, in this context, the large external imbalances in some countries deserve attention.

The **monetary stance in the euro area** remains supportive of the recovery as interest rates are still very low even with the withdrawal of some of the stimulus by the ECB. The substantial gap between headline and core inflation indicates that the oil price hike has so far not led to significant indirect effects on non-energy prices. Both consumer surveys and inflation-indexed bonds suggest that inflation expectations remain well-anchored and year-on-year headline inflation is expected to continue to ease gradually in the course of 2006.

Seven of the new Member States are now participating in the **Exchange Rate Mechanism** (ERM II), which aims at fostering convergence and facilitating countries' preparation for eventual euro adoption. ERM II has been functioning smoothly, testament to a high degree of policy credibility. Over the coming years, some new Member States are set to join the euro area, provided that they have achieved a high degree of sustainable convergence. This will be another major next step in European monetary integration.

Against the background of improved growth prospects, ambitious **budgetary consolidation** remains a priority for a number of Member States, in order to reduce high levels of public debt. As the euro-area economy begins to reach its potential growth rate, a number of Member States should seek to undertake an annual adjustment, in structural terms, of at least 0.5% of GDP. This is particularly important given the large projected impact of population ageing on the long-term sustainability of public finances.

The first experiences with the **revised Stability and Growth Pact** are encouraging. Member States' medium term budgetary plans are in line with the principles agreed in the revised Pact. Surveillance of budgetary developments has been reinforced. Recommendations for the correction of excessive deficits are now better able to take into account the economic situation in individual countries. Ownership of the fiscal rules by Member States has increased substantially.

European competitiveness is expected to be stimulated in the context of the re-launched **Lisbon Strategy**. Accelerating the implementation of structural reforms would allow the EU to better respond to the challenges of globalisation and ageing populations. The new governance arrangements of the Strategy emphasise partnership between Member States and the Commission, introducing National Reform Programmes as an instrument to strengthen national ownership of the reform agenda. Based on common policy orientations, these programmes set out the national strategies geared to the specifics of each country. Furthermore, the Commission intends to establish a **European Globalisation Adjustment Fund.** This Fund would provide EU Member States with additional support for workers made redundant as a result of major structural changes in world trade patterns, and to assist them with their re-training and job search efforts. It should become operational on 1 January 2007.

The **EU financial integration** process has benefited from the introduction of the euro and subsequent efforts to create a common EU regulatory framework. The pace of integration has accelerated markedly in recent years, although the degree of progress has varied across market segments. In the longer term, an integrated and efficient EU financial market will raise the growth potential of the EU economy by improving the allocation of capital, enhancing productivity and providing wider opportunities for risk sharing. Financial integration is therefore a key objective in the Lisbon strategy. The next phase of the integration process will focus on the consolidation of existing measures by means of improved transposition at national level, proper enforcement and continuous evaluation based on broad consultation and impact assessments.

As to further **enlargement**, the European Council will decide in June whether Bulgaria and Romania will accede in 2007 or 2008. Accession negotiations with Croatia and Turkey started last October, but may last several years. In these countries, as well as in the Former Yugoslav Republic of Macedonia, a candidate country since December 2005, the accession prospect continues to serve as a powerful anchor for stabilisation and reform. The European Commission is stepping up its monitoring role. The Commission also actively supports the EU perspective of the other Western Balkan countries.

Strengthening progress towards the Millennium Development Goals remains an overarching political priority of **EU development policy**. The EU is currently well on track towards achieving ambitious targets for scaling up Official Development Assistance (ODA) with a view to the 0.7% of GNI UN target by 2015, through intermediate targets in 2006 and 2010. The EU is already the largest world donor, giving more than half of all ODA, and will contribute about 80% to its scaling up worldwide by 2015, providing collectively at least half of this increase to Africa. In December 2005, the EU adopted the European Consensus on Development, a breakthrough for European development cooperation. For the first time in 50 years of development cooperation, the EU and its 25 Member States agreed on a common vision for actions. Joint strategic multi-annual planning of aid at country and regional level, co-financing of development aid and progress on donor complementarity are the crucial

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elements to enhance the effectiveness of EU aid to partner countries. Joint processes with non-EU donors will be supported wherever possible.

A successful and well balanced conclusion of the **Doha Development Agenda** is a top priority of EU trade policy. In order to reach a successful outcome, the Round has to respond to the interests of all WTO members and cannot focus on one single issue. A truly ambitious result in terms of real gains in market access, alongside stronger and better multilateral trade rules, is crucial to strengthening global growth and making further progress with poverty reduction and the achievement of the Millennium Development Goals. The EU remains committed to the development aspects of the round, via increased market access for developing countries, including on South-South trade, the removal of trade distorting subsidies and commercial practices, and special and differential treatment. The European Commission also encourages all developed countries to agree on a final date for full duty and quota free access to imports from Least Developed Countries. In Hong Kong, the European Commission confirmed that it will increase its support for Aid for Trade to € 2 bn by 2010. The increase will not be funded at the expense of other development priorities. Aid for Trade is a necessary complement of the market access and rules agenda to ensure that poorer countries will be able to benefit more from new and existing opportunities to trade. In view of the end April deadlines for modalities in agriculture and industrial tariffs, there is an urgent need for all WTO members to demonstrate their political commitment to the Round by taking the necessary decisions.

The world economy has weathered the doubling of oil prices well. However, the continued tightness of the oil market poses a risk to global growth. The European Commission encourages oil producing countries to improve their investment climate in order to facilitate an expansion of their supply capacity, while emphasising the need for consumer countries to moderate demand by increasing energy efficiency, and making use of innovative technologies and new sources of energy. Additionally, further efforts in improving the transparency of oil markets are needed. In response to the new challenges of increased supply concerns, high energy prices, increased competition for supply and a projected increase of import dependency, a common European energy policy is currently being discussed. The Commission's Green Paper on Energy, which has been endorsed by the EU Heads of State and Government, proposes to base European energy policy on the three key goals competitiveness, sustainability and security of supply. Next steps are to set up a timetable and a prioritised action plan for more detailed policy measures.

Over-valued housing prices in a number of countries and widening **global imbalances** also represent non-negligible downside risks to an otherwise relatively benign growth outlook. To reduce the risk of a disorderly correction, all major regions should implement appropriate preventive policies to reduce their domestic imbalances. The best strategy to lower the risk of a disruptive adjustment is for the **United States** to strengthen efforts to raise domestic public and private saving. **Europe** and **Japan** needs to increase its potential rate of growth through an accelerated implementation of structural reforms. **China** should move to more consumption-led growth which could help to ensure a better balanced medium-term growth pattern of the economy. An improvement of both the social security system and the financial system could contribute to reduce excessive domestic savings and hence the current account surplus. Greater exchange rate flexibility would also contribute to this adjustment. This is also true in other countries where this flexibility has been lacking up to now.

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The Commission supports the proposals made by Managing Director Rato in the context of the **strategic review** of the Bretton Woods Institutions. Strengthening the voice and representation of emerging market and developing countries in the Bretton Woods Institutions is an important objective for the institution. Progress with the adaptation of financial instruments and re-focussing on core responsibilities would also contribute to improving the role of the IMF in emerging market and developing countries. Surveillance remains central to the Fund's role in promoting sound economic policies and financial stability. To this end, surveillance needs to be made more effective by better integrating its various components, including by an increased focus on exchange rate developments.

The fight against **money laundering and the financing of terrorism** continues to be a high priority. 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 the regular assessments of member countries' strategies and measures by the IMF and the World Bank as part of this surveillance. This evaluation helps to identify key areas where efforts and assistance need to be concentrated. Thanks to their expertise and global view, the IMF and World Bank can make valuable contributions through coordinating the assistance.