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On behalf of the European Commission

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

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The **global economy** continues to expand at a robust, if somewhat slower pace, compared to last year. World growth has become better balanced, with the rest of the world so far proving fairly resilient to the slowdown in the US. Developing and emerging market economies, in particular, continue to grow vividly. So far, the world economy has handled the sustained high level of energy prices well. While oil prices have come down from their peaks of last year, the recent rise in oil prices shows that the oil market continues to be tight in a context of accelerating oil demand and lingering supply concerns. In this context, 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 Commission welcomes the progress made in improving the transparency of oil markets, and encourages further efforts.

In the context of these developments, the **EU economy** is expanding with a very good momentum, and the recovery continues to broaden. Latest survey indicators suggest that growth has remained firm in early 2007. The labour market continues to improve and unemployment has dropped to its lowest level during this decade. The Commission expects a continuation of these positive trends throughout the year, with GDP growth projected to reach 2.7% for the year as a whole. In the ten Member States that joined the EU in 2004 the process of real converge continued in 2006 and is expected to do so over the period 2007-08. In Bulgaria and Romania, which entered the European Union on 1 January 2007, output growth accelerated in the run-up to EU accession, and expectations are that these two countries will continue to grow well above the EU average in 2007-08. As a counterpart of buoyant domestically-led growth, in some of the newly acceded twelve Member States current account imbalances have risen strongly and private sector indebtedness has reached very high levels. The Commission, together with the relevant Member States, is monitoring these developments closely.

As regards **euro area enlargement**, Slovenia was the first of the recently acceded EU Member States to join the euro area in January 2007. Cyprus and Malta currently aspire to join, and if they succeed in their convergence efforts the euro area will expand to fifteen members by 2008. For most other newly acceded EU Member States the convergence towards the euro continues, even if entry dates had to be postponed in a number of cases. The EU's exchange rate mechanism (ERM II) provides a useful policy framework that promotes stability and creates the foundations for sustainable long-term economic growth. By securing more stable exchange rate conditions EU Member States can prepare for euro area accession and make progress towards real and nominal convergence.

In view of the overall strong economic recovery, **macroeconomic policies in the euro area** have been adjusted. The ECB has continued to withdraw monetary stimulus, but monetary policy remains on the accommodative side and financing conditions are favourable for both businesses and households. Headline HICP inflation has stayed below the 2% benchmark in the last months, largely as a result of more favourable energy price developments. Looking ahead, inflation expectations should remain well contained. Public finances in the European economies are benefiting from the economic rebound. In 2006, due to robust economic growth and buoyant revenues, the nominal fiscal deficit of the euro area narrowed more than expected, falling to 1.7% of GDP.

Fiscal consolidation was most pronounced in those euro area countries with an excessive deficit, i.e. a deficit above 3% of GDP. Almost all of them are planning to make the necessary adjustments by the end of this year. This confirms that the revised **Stability and Growth Pact** is working smoothly towards securing more sustainable public finances. However, looking ahead, aging populations will impose further pressure on public finances. Advantage needs to be taken of the current positive economic outlook to engage in even more ambitious fiscal policies. This would create a budgetary margin of manoeuvre, allowing EU Member States to withstand the next economic downturn without breaching the 3% of GDP ceiling.

There are signs that **global current account imbalances** are stabilising, since over the past year market and macroeconomic developments have been moving in the right direction. However, there have also been developments that continue to put upward pressure on imbalances. In the **US**, while the current account deficit has widened further in 2006, the fiscal deficit has narrowed. However, it remains necessary to adjust fiscal policy further to set public finances on a prudent medium-term course. Both fiscal consolidation and measures to encourage private saving would help to reduce the US current account deficit. For **Japan**, with its rapidly ageing population and the prospects for higher interest payments, the consolidation of public finances is a key challenge. Comprehensive structural reforms would increase Japan’s potential rate of growth and would contribute to the reduction of Japan's large current account surplus. In **China**, trade and current account surpluses have grown considerably, and figures for 2007 are expected to reach new record heights. The reduction of domestic and external imbalances, including by allowing for greater exchange rate flexibility, remain a key challenge for the future. Overall, while the downside risk from a possible disorderly unwinding of global imbalances has receded somewhat, it remains a concern. In the IMF's multilateral consultation framework some progress has been made towards addressing the necessary need for action, in particular by publishing commitments from each participant on specific policy intentions for the future. This is a positive outcome. All participants involved in the multilateral consultations now have to live up to their commitments.

For Europe, this means delivering on our **reform strategy** – as endorsed by European Heads of State and Government in March – and making further progress with structural reforms in product, labour and financial markets. The recent assessment conducted by the Commission confirms that EU Member States are committed to rigorous reforms. National governments are making good progress in building a knowledge-based economy and improving competitiveness. In particular, measures have been taken that contribute to enhancing R&D and innovation systems and promote entrepreneurial dynamism by cutting administrative red tape and improving incentives to start-up and develop businesses. In labour markets, reforms focus on improving the quality of labour market policies and raising the quality standards of education and training systems. At the Community level, important legislation was adopted in

2006 on the liberalisation of services, which will stimulate reforms and provide a positive boost to competitiveness.

Deepening **financial integration** is an important element in the EU's reform strategy. 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. The process of EU financial integration is already well under way and will intensify further. Areas of priority for the next years are the timely and consistent transposition of the legislative measures identified in the EU's Financial Services Action Plan into national law, and the continuous ex-post evaluation of the implementation of these measures. As the pace of cross-border consolidation among financial intermediaries has now begun to accelerate, it is 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.

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

An area of highest priority is the eradication of poverty and the achievement of the Millennium Development Goals. This remains the core objective of the **EU's development policy**. It is widely recognised that achieving these goals requires, in addition to policy reforms in partner countries, also more and better aid. EU official development aid (ODA) in 2006 accounted for more than half of all ODA in the world. EU ODA is already above the target of 0.39% of gross national income the EU set itself for 2006, and on track to achieve the 0.56% target set for 2010. The programming of the European Development Fund for the period 2008 to 2013 puts into effect the principles of the Paris Declaration on aid effectiveness. Since poverty is most prevalent in the African continent, the EU continues to give priority to the implementation of its EU-Africa Strategy with its focus on supporting political stability, good governance, infrastructure investment and trade facilitation. A new EU Infrastructure Trust Fund to help finance infrastructure projects in Africa will start operating this year. With a view to the EU-Africa Summit planned for the end of this year, the EU is currently elaborating a Joint EU-Africa Strategy, together with its African partners. Also, the Commission recently proposed a strategy to put into effect the EU's promise to make available €2 billion for trade-related assistance by 2010.

Since trade has a large role to play in the promotion of development, much is at stake given that the window for concluding the **Doha Development Agenda** (DDA) by 2008 is narrowing. This is another key international challenge. It will require an equal level of commitment by all major players. The benefits of the DDA for the world economy are large, and will, by far, outweigh the short-term sacrifices that may need to be made. While the DDA and the multilateral trading system remain the EU's overarching trade policy priority, the EU has decided to pursue simultaneously a range of bilateral **free trade agreements** (FTAs) with key trading partners. Carefully targeted and properly designed FTAs can yield significant economic benefits, for both participants and third countries. Provided that they are consistent with WTO rules, the new generation of FTAs can serve as "building blocks" for multilateral liberalisation.

Energy sustainability and climate change provide another common challenge to which the international community must give a coordinated response, and one on which the EU has decided to focus. At their meeting in March, European Heads of State and Government outlined a new "Energy Policy for Europe". It aims to increase the security of supply, ensure the competitiveness of European economies and the availability of affordable energy as well as promote environmental sustainability and combat climate change. As a milestone in European energy policy, European Leaders adopted a comprehensive action plan with highly ambitious targets. Energy efficiency as well as the share of renewable energies in overall EU energy consumption shall be improved by 20% in 2020, with a separate target of a 10% increase for bio fuels. On a global level, the Commission intends to put forward in 2007 a proposal for a new international agreement on energy efficiency. The key element of such an agreement should be to commit to common approaches for saving energy. Regarding climate policy, European Heads stipulated a firm commitment for the EU to reduce its greenhouse gas emissions by 20% in 2020. Moreover, an even more ambitious reduction of 30% is envisaged provided that an international agreement on comparable reduction targets can be reached. Developing countries are invited to come forward with proposals for their contributions to such an agreement.

Strengthening the international financial architecture, including through a reform of the Bretton Woods Institutions, is another key global challenge. The Commission fully supports the ongoing efforts towards a comprehensive **IMF reform** that will find broad support within the IMF membership and will help to maintain and enhance the credibility and legitimacy of the IMF. In this regard, the first round of ad-hoc quota increases for the four most underrepresented countries in the IMF was a step in the right direction. After the Spring Meetings, the debate needs to continue in order to meet the deadline set in the Singapore resolution. While a number of the more fundamental issues, including the revisions of the quota formula and the surveillance framework, remain to be settled, the intensive discussions in various international and EU fora in the last months have already defined important areas of broad consensus. If the debate continues in a cooperative spirit, an agreement should be possible in the near future.

Finally, let me conclude with a few words on the **fight against money laundering and the financing of terrorism**, which 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. With the beginning of this year, the "Regulation on information on the payer accompanying transfers of funds", which improves the information on the identity of senders of funds, went into force. 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 their surveillance. 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.