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Statement of Vice President Olli Rehn to the International Monetary and Financial Committee on behalf of the European Commission

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Strong policy measures in the past few months helped avert the derailment of global growth recovery. However, risks to the outlook remain elevated.

The euro area economy is going through a mild recession. After a weak third quarter, **GDP growth** contracted in the fourth quarter by 0.3% in the EU and the euro area. Signs of a stabilisation have recently appeared and a gradual return to growth is projected for the second half of 2012. For 2012 as a whole, GDP growth is expected to be zero for the EU and -0.3% for the euro area. Although still tilted to the downside, risks to the outlook appear more balanced than in the autumn. Turning to the external environment, intensified geopolitical tensions could trigger a surge in oil prices weighing on economic growth. On the upside, confidence might be restored faster and global demand might be more robust than expected.

Headline **inflation** in the euro area was 2.6% in March after having peaked at 3% in autumn 2011. Core inflation has remained stable at 1.9% since the beginning of the year. Energy prices played a major role in the moderation of headline inflation since autumn, as they did in its rise before. Inflation differentials across Member States remain sizeable but are declining. Inflation expectations remain well anchored. Looking ahead, euro area headline inflation is expected to return gradually to below 2%, though at a slower pace than expected some months ago. The risks around the inflation outlook appear broadly balanced and relate mainly to oil prices and economic growth.

The Euro area is delivering on its comprehensive **five-point strategy for crisis response to address the sovereign debt crisis**. We are addressing the challenges of vulnerable countries; strengthening euro area financial firewalls; funding and recapitalising banks; strengthening economic governance in the euro area; and supporting growth through structural reform and differentiated and growth friendly fiscal consolidation.

First, as regards **country policies**, the European Commission welcomes the agreement reached with the Greek government on a policy package that constitutes the basis for a second adjustment programme. This new programme provides a comprehensive blueprint for putting the public finances and the economy of Greece back on a sustainable footing, hence safeguarding financial stability in Greece and in the euro area as a whole. Portugal and Ireland have made significant progress in implementing their EU/IMF programmes, which remain fully on track. In Italy and Spain, governments are well aware of the challenges and have adopted a number of important fiscal and structural measures, which contributed to easing market pressure. The Spanish government is making determined efforts to underpin the 2012 deficit targets and to bring its debt on a sustainable path. Spain has also introduced ambitious reforms of the labour market that should increase the growth potential of the country and to consolidate the banking sector. In Italy, in the past few months, the government has shown strong determination and an impressive commitment to take up the twin challenges of fiscal consolidation and growth by adopting measures which will deliver a balanced budget in structural terms in 2013 and reforming product and labour markets.

Second, the EU has made significant progress on enhancing and increasing its **firewalls.** We agreed on 30 March on an accelerated calendar for the payment of the € 80 billion paid-in capital of the European Stability Mechanism (ESM), ensuring a timely availability of its lending capacity. For a transitional period until mid-2013, the European Financial Stability Facility (EFSF) may engage in new programmes in order to ensure a full fresh lending capacity of € 500 billion. We also agreed that the combined EFSF/ESM lending ceiling will be raised to € 700 billion. The overall firewall, including the amounts already committed under the Greek Loan Facility and the EFSM, amounts to approximately € 800 billion, more than $ 1 trillion, which is being mobilised to ensure financial stability of the euro area.

Third, **bank recapitalisation** is progressing. The ECB's long-term funding operations have alleviated some of the pressure on banks to de-lever disorderly and have given breathing space in the short term. The European Banking Authority expects that banks will reach the target capital ratio set for end-June 2012 with only limited recourse to deleveraging. Measures submitted so far address the shortfall in full and create an additional buffer of approximately 26% of the initial shortfall. According to this preliminary assessment, measures with a direct positive impact on capital account for over 95% of the initial shortfall on an aggregate basis. There is no evidence so far that the implied deleveraging process has become excessive or disorderly.

Fourth, on 2 March the European leaders agreed to boost **growth and jobs** at the EU and national level by: (i) pursuing differentiated, growth-friendly, fiscal consolidation; (ii) restoring normal lending to the economy; (iii) promoting competitiveness; (iv) tackling unemployment and the social consequences of the crisis; and (v) modernising public administration. European Leaders also agreed to continue to strengthen the EU single market; to complete the Digital Single Market by 2015; and to reduce the administrative and regulatory burdens at EU and national level.

Fifth, the global economic and financial crises have exposed weaknesses in **economic and budgetary governance** in the EU and euro area. On 2 March, 25 Member States signed a new "Treaty on Stability, Coordination and Governance in the Economic and Monetary Union". The Treaty foresees that Member States will enshrine in their national legal system, preferably through constitutional provisions, a rule ensuring the achievement of their country-specific medium term objectives. In case of a deviation from the fiscal objective an automatic correction mechanism is triggered. It thereby adds to the already considerable progress achieved last year with the so-called "six-pack", i.e. the set of legislative acts that radically reform the macroeconomic and fiscal surveillance of all 27 Member States. Further legislative proposals on the 'two-pack' to complete this set of rules are being processed by the Council and the European Parliament.

A significant tightening of the **fiscal stance** is projected in 2011-2013 in most Member States. Persistent tensions in EU sovereign debt markets, together with the need to bring down currently high debt ratios to prudent levels in most Member States, imply that fiscal consolidation remains the only viable strategy to support economic stability. In order to underpin their credibility, consolidation efforts should be accompanied by growth-enhancing structural reforms and by reforms that reinforce the sustainability of public finances in the medium term. The speed of fiscal adjustment should be differentiated by country according to their specific fiscal and macro-financial circumstances. All Member States should continue to respect their commitments according to the rules of the Stability and Growth Pact, which allow the automatic stabilisers to work around the agreed path of structural fiscal adjustment, while ensuring the long term sustainability of public finances. Given their particular situation, Member States benefiting from a financial assistance programme should stick to the targets as agreed in their programme and should fully and timely implement the policy measures, including in particular structural reforms, agreed in the respective Memorandum of Understanding. Similarly, Member States facing close market scrutiny should continue to meet the agreed budgetary targets and stand ready to pursue further consolidation measures if needed.

The EU is also strongly committed to put all major **financial reforms** in place by 2013**.** We have adopted new rules for OTC derivatives. Basel 2.5 has been adopted and work on implementing Basel 3 is well advanced. We have draft legislation on table on credit rating agencies, both to reduce undue reliance on them and to regulate them more effectively. A key outstanding area where the G20 and FSB have recommended action is establishing effective recovery and resolution regimes. We remain committed to adopting an EU framework for resolution in line with the FSB key attributes. International cooperation will be critical in 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. The EU strongly supports full and effective delivery on the objectives of improving the FSB governance and strengthening its decision-making process, outreach and resources.

We have made significant reform progress in recent years to **increase the legitimacy, credibility and effectiveness of the International Monetary Fund**. It is important that we continue our efforts to enhance the Fund's capability to address the challenges of today's international monetary and financial system.

EU Member States support a substantial **increase in the IMF's resources**. As part of a broader international effort to improve the adequacy of IMF resources, euro area Member States have committed € 150 billion of additional resources through bilateral loans to the Fund's General Resources Account. Other EU Member States have also committed to contribute to the IMF resources. We call on all financially strong IMF members to support the efforts to safeguard global financial stability by contributing to the increase in IMF resources to fill potential global financing gaps. Decisions on the modalities of the new bilateral loans to the IMF should be guided by the following principles: first, the EU considers that existing policies and rules related to Fund lending should continue to be applied rigorously and in the same way for all Fund members, in line with the IMF's long-standing principle of equal treatment and second, the primary tool to mitigate any risks to the IMF is the strength of the Fund's policies on programme design, conditionality and access.

The EU looks forward to the implementation of **improvements in IMF surveillance** in the priority areas identified in the 2011 Triennial Surveillance Review. The EU welcomes the building blocks put forward by the IMF for an Integrated Surveillance decision (ISD). In order to enhance the traction of IMF surveillance, the EU supports greater monitoring of follow-up of the IMF’s policy advice.

Finally, key aspects of the 2010 IMF **quota and governance reform** are yet to be implemented. We call on all IMF members to approve the reform by the agreed deadline of the 2012 Annual Meetings. A number of EU Member States have already concluded national ratification procedures and the process is projected to be completed by all by the deadline. EU Member States will play a constructive role in forthcoming discussions on the review of the current IMF quota formula. Further governance reforms to improve IMF accountability, oversight and effectiveness should be an integral part of further discussions on IMF quotas and governance.