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EU Council of Economic and Finance Ministers

Statement by Minister of Finance, Vassos Shiarly in his capacity as Chairman of the EU Council of Economic and Finance Ministers, at the IMFC Annual Meeting, Tokyo, October 13, 2012

1. I submit, in my capacity as Chairman of the EU Council of Economic and Finance Ministers, this statement which focuses notably on the world economy, in particular the outlook and policy challenges, and on IMF policy issues.

I. ECONOMIC SITUATION AND OUTLOOK

2. While strong policy measures in late 2011 and early 2012 helped avert the derailment of the global growth recovery, GDP growth and other principal indicators of the global economy have weakened significantly across developed and emerging markets. As a result, the recovery expected in 2012 is turning out to be fragile.

3. The central scenario of the European Commission remains that of a mild recession for the euro area in 2012, followed by a moderate recovery setting in from 2013. In light of recent economic data releases the recovery might materialise somewhat later than previously expected and downside risks prevail.

4. We can see important evidence of rebalancing across the euro area. Wages are being adjusted in line with productivity levels. The adjustment has been particularly strong where deficits had been very large at the start of the crisis, as reflected in large declines in relative unit labour costs in several countries in 2011, while these adjustments are expected to advance further in 2012-13. Surplus countries are recording increasing wages. This is reflected in a correction of the current account developments.

5. Risks to the global growth outlook remain elevated. Recent data releases highlight that remaining risks in the euro area, the US fiscal deadlock, and slowing growth in major emerging economies are all interacting to dampen growth prospects.

Policy challenges

6. As demonstrated by the agreements of the euro area summit and the European Council on 28-29 June, and further measures agreed since then, euro area leaders are taking all necessary measures to safeguard the integrity and stability of the euro area, in line with the comprehensive strategy for crisis response.

- While significant challenges remain, further progress has been made on the stabilisation of vulnerable and programme countries in the euro area. The first review mission under the Second Economic Adjustment Programme for Greece is underway. Since July, the mission has had productive discussions with the authorities and has made good progress. The mission is still on-going and discussions have resumed as of 1 October. The Irish programme remains well on track, and Ireland has managed a successful issuance of T-bills in July and September 2012 and also a return to the long term bond market in July and August 2012, underlining its further progress towards the objective of regaining sustainable access to international capital markets during 2013. In addition, the Euro Summit stated in June that the Eurogroup will examine the situation of the Irish financial sector, with a view to further improving the sustainability of its well-performing adjustment programme. The Portuguese programme also remains broadly on track. The Portuguese authorities continue showing their strong commitment to the programme and have made further progress in undertaking important fiscal and structural reforms in line with the agreed policy conditionality. As regards Spain, euro-area finance ministers agreed unanimously to extend financial assistance for the recapitalisation of financial institutions in response to the Spanish authorities' request. The financial assistance which will cover financing needs of up to EUR 100 bn is accompanied by financial sector specific conditionality, as enshrined in a Memorandum of Understanding. Implementation of agreed measures is well on track. For Cyprus, a fully-fledged programme is expected to be negotiated with the Cyprus authorities.

- The Treaty establishing the European Stability Mechanism has been ratified by all euro area member states and entered into force on 27 September. On 29 June 2012, the Heads of State or Government of the euro area reaffirmed their commitment to "using the existing EFSF/ESM instruments in a flexible and efficient manner in order to stabilize markets".

- Further progress has been made with action to repairing the banking system. Compliance with the Recommendation has been achieved mainly via direct capital impact measures, while disorderly deleveraging (i.e. reduced lending and fire sales) was mitigated by a strict monitoring of capital plans.

- Concrete steps are underway to establish a single supervisory mechanism under the aegis of the ECB. On 12 September, the European Commission has made a legislative proposal for a single supervisory mechanism, involving the European Central Bank. Such a single supervisory mechanism could help to break the vicious circle between banks and sovereigns.

- To this end, beyond fiscal discipline, risk in bank's balance sheets will have to be reduced and diversified over several years, while business models need to adjust in parallel. This implies a period of several years where enhanced, effective supervision both at micro- and macroprudential level will be critical. If reducing the interdependence between banks and sovereigns really is to be achieved, establishing an effective single supervisor will be essential. When an effective single supervisory mechanism is established, the ESM could, following a regular decision, have the possibility to recapitalize banks directly. Technical discussions to develop the framework for future direct bank recapitalisation will follow. State aid control will remain essential in order to maintain the integrity of the EU single market.

- The ECB decided on 6 September on the modalities for undertaking Outright Monetary Transactions (OMTs) in secondary markets for sovereign bonds in the euro area, to safeguard an appropriate monetary policy transmission and the singleness of the ECB's monetary policy. OMTs will enable the ECB to address severe distortions in government bond markets. Interventions will focus on bonds with a one to three year remaining maturity. Compliance with strict and effective conditionality attached to appropriate EFSF/ESM programmes that include the possibility of EFSF/ESM primary market purchases is a necessary condition for any undertaking of OMTs. The operations will be fully sterilised. Also, the ECB decided on additional measures to preserve collateral availability for counterparties in order to maintain their access to the Eurosystem's liquidity operations.

- The EU is supporting growth through structural reform and differentiated and growth friendly fiscal consolidation. On 29 June, the EU Heads of State or Government adopted a "Compact for Growth and Jobs", which encompasses action to be taken by the Member States and the European Union with the aim of re-launching growth, investment and employment as well as making Europe more competitive. In an effort to boost the financing of the economy, EUR 120bn are being mobilised for fast-acting growth measures, including through an EIB capital increase, allowing for an enhanced overall lending capacity and the pilot use of project bonds for key infrastructure projects.

- Economic and budgetary surveillance in the EU has been strengthened through the adoption of the legislative package known as the "Six Pack", which entered into force at the end of 2011. A further strengthening for euro area Member States will take place through the so-called "two pack" which is currently being negotiated with the European Parliament and is expected to be adopted soon. Moreover, the intergovernmental Treaty on Stability, Coordination and Governance, signed by 25 Member States in March 2012 should help to prevent unsustainable fiscal policies in particular through a balanced budget rule and automatic correction mechanisms to be enshrined at national level. These reforms make the necessary budgetary consolidation at Member States' level more credible and equip the EU with much better tools to appropriately respond to future crises.

- Finally, the President of the European Council, together with the Presidents of the Commission, the Eurogroup and the European Central Bank, is also working on a specific and time-bound roadmap for the achievement of a genuine European Monetary Union commensurate with a single currency, covering the 'four essential building blocks' for the future EMU: an integrated financial framework, an integrated budgetary framework, an integrated economic policy framework and strengthened democratic legitimacy and accountability.

7. The EU considers that further progress is needed to both address short-term vulnerabilities and to strengthen the medium-term foundations for growth as committed by G20 countries at Los Cabos in June. Effectively bridging the gap between short-term priorities and medium-term goals is essential. While global imbalances have narrowed with the crisis (although in part due to weaker demand in deficit countries), we should not lose sight of the need to implement decisive policy action to bring them to desirable levels on a sustainable basis. This would be helped by a more rapid move toward market-determined exchange rate systems and strengthened private consumption in emerging surplus countries; the implementation of credible fiscal consolidation plans in all advanced economies; also observing the G20 fiscal commitment agreed at the Toronto summit; and the implementation of structural reforms that boost domestic demand and growth in surplus countries and improve competitiveness and growth in deficit countries. The EU believes that the G20 should identify credible and ambitious country-specific fiscal targets by the time of the next Summit.

8. The EU is approaching the end of its most comprehensive programme of financial services reform. Around thirty measures have been proposed or adopted since the financial crisis began, including all the key commitments agreed at the G20. All new legislation should be in force by 2013. The reform programme includes the timely and consistent implementation of Basel III; a full and consistent implementation of remuneration principles and standards; the implementation of the OTC derivatives recommendations endorsed by the G20 through the European Market Infrastructure Regulation (EMIR); the revision of the Markets in Financial Instruments Directive, the Market Abuse Directive (including new provisions to address misuse of benchmarks) and the Transparency Directive; legislation on Short Selling and Credit Default Swaps; and, a new crisis management and resolution framework for the financial sector in line with the FSB Key Attributes. In addition, new or amended regulation has been or will be proposed on Credit Rating Agencies, Central Securities Depositories and the harmonisation of certain aspects of securities settlement, as well as on Solvency II for the insurance sector. The EU is looking forward to further progress, at international level, on identifying and listing non-cooperative jurisdictions, as well as in relation to shadow banking, and remains committed to working with its international partners in this context.

II. IMF POLICY ISSUES

9. 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.

10. In this context, we emphasize the importance of the agreement to increase IMF resources at the IMFC and G20 meetings in April 2012 and welcome additional pledges at the G20 Summit in Los Cabos, resulting in total additional resources of USD 456 billion. Together with the increase of the European firewalls to support financial stability of the euro area, this will strengthen the ability of the international community to provide effective responses at the global level to challenges IMF members may face. We welcome the upcoming signing of a first group of 10 bilateral loan agreements between the Fund and IMF members, for an amount of USD 286 bn. and encourage other contributors to take the necessary actions to make their commitment effective quickly. We reiterate that the resources will provide a temporary second line of defence for the IMF and will be available to all members, subject to the IMF's traditional lending and risk mitigation policies.

Governance

11. In order to further increase the legitimacy, credibility and effectiveness of the International Monetary Fund, full implementation of the 2010 Quota and Governance Reform is of utmost importance. We reiterate the urgency of promptly concluding the agreed reform, and urge all countries that have not yet implemented the necessary domestic procedures for the quota increase and the Board Reform Amendment to complete the ratification process. We ask the IMF to spur the process and to regularly report on the progress toward effective implementation of the 2010 quota and governance reform in order to put the reform into effect as soon as possible.

12. EU Member States are aware of their responsibility in successfully and comprehensively implementing all elements of the 2010 IMF quota and governance reforms and are working on implementing it in full. 22 EU Member States have already fully concluded national ratification procedures for the 2010 Quota and Governance Reform. Advanced European countries reaffirm their commitment to reduce their Executive Board representation by two chairs as part of the 2010 IMF quota and governance reform agreement by the time of the first regular election of the Executive Board after implementation of the 2010 quota and governance reform.

13. EU Member States consider that the quota formula review needs to be fully anchored within the relevant IMF bodies, with a view to engage the wider IMF membership. The four principles which underpinned the 2008 reform of the quota formula continue to provide the appropriate basis for the current review. In particular, EU Member States believe that it is important that the formula seeks to capture the multiple roles of quotas. Quotas should continue to reflect not only members' relative positions in the world economy, but also their stake in promoting global economic and financial stability as well as their financial strength and ability to contribute usable resources. In light of this, EU Member States believe that GDP and openness should remain the main variables and consider that openness should carry an increased weight in the formula.

14. Further governance reforms to improve IMF accountability, oversight and effectiveness should be an integral part of further discussions on IMF governance and quotas. In this regard, enhanced engagement of ministers and central bank governors in the strategic oversight of the IMF is needed.

Surveillance

15. The EU welcomes the adoption of the Integrated Surveillance Decision that will ensure a better integration of bilateral, regional and multilateral surveillance. We also welcome the External Balance Assessment exercise and the pilot External Sector Report (ESR) which represents a useful addition to the Fund's multilateral surveillance We look forward to the continuous review and adjustment of the methodology and data used in the External Balance Assessment exercise in order to improve and refine its tools and results and further refinement of the ESR, in particular to take into account the specificities of countries within currency unions. With regard to the separate publication of the ESR, we see merit in some streamlining of the various surveillance products to help foster the traction of the policy advice and to focus the Fund's messages. The EU also welcomes the IMF’s 2012 annual update on outward spillovers from the systemic 5 countries/regions.

16. Beyond the recent improvements in Fund Surveillance, the EU considers that the coverage of financial sector issues, macro-financial linkages, and the assessment of risks should be further strengthened in IMF surveillance. The identification of adverse feedback loops between financial sector developments and the real economy should be improved. We broadly welcome the Fund's Financial Surveillance Strategy, recently adopted by the Executive Board, clarifying the role of the IMF in this area. The EU considers it important that the IMF regularly monitors and assesses gross cross-border capital flows, their transmission channels and management measures, including possible implications for other countries. In this context, we look forward to the presentation of a comprehensive capital flows framework by the Fund.

17. In order to enhance the traction of IMF surveillance, and to improve monitoring, it would be useful if Article IV reports more consistently reviewed members' follow-up to previous IMF surveillance advice and the quality and relevance of the Fund's previous analysis and recommendations. The EU furthermore supports mandatory and timely publication of annual Article IV reviews. Systemically important countries/regions should lead by example. The policy debate within the IMF should, besides discussion in the Board, also take place at a sufficiently senior political level. The IMFC could play an enhanced role in this regard.

18. Moreover, EU Member States recall the need for IMF members to fully respect their obligations under the Articles of Agreement (AoA). In particular, access to information that is as timely, complete and accurate as possible is essential for every aspect of Fund's activities, including crisis prevention and resolution. In order for the Fund to be able to carry out its responsibilities, EU Member States stress the importance for IMF members to respect their obligations regarding the provision of information according to Article VIII, Section 5 of the Article of Agreements. In particular, we would like to highlight the need for statistical correctness in reporting to the Fund. In case of non-compliance by an IMF member, peer pressure can play an important role in addition to remedial measures and sanctions laid down in Article VIII, Section 5, AoA, together with the Decision on Strengthening the Effectiveness of Article VIII, Section 5.

IMF's support to low-income countries

19. We welcome the recent review of IMF facilities for low income countries (LIC) which provides a good starting point for further discussions on this issue. We recognize the importance of the Fund's role in helping to address balance of payments problems, mitigating shocks and supporting macroeconomic stabilization, growth, and poverty reduction. Given the potential sharp drop in the Fund's concessional capacity after 2014, the IMF members have to collectively ensure that the PRGT has adequate resources to support its low income countries members. Given the scarcity of PRGT resources, they must be efficiently used according to the Fund's mandate, with appropriate conditionality attached. In this regard, we welcome the approval of the IMF Executive Board on 28 September to distribute SDR 1.75 bn. (USD 2.7 bn.) in remaining windfall gold sales profits as part of a strategy to bolster the IMF's concessional lending vehicle for low-income countries and make it sustainable. The resources are in addition to the SDR 700 million (USD 1.1 bn.) that have already been approved to be used to support low-income countries.