

SPEECH
for Commissioner Almunia
European Finance Convention
'Resolving the Financial Market
Crisis: the need for a global
response'
3rd December 2008

Fostering financial stability: European and global actions

Ladies and gentlemen,

Let me begin by thanking the European Finance Convention for inviting me to speak today on such a critical subject.

For the last year we have seen the turmoil that originated in the US sub-prime mortgage market impact the functioning of financial markets the world over.

The situation turned out to be worse this autumn. The collapse of Lehman Brothers, in September, pushed the financial system to crisis point and sent the banking sector to the brink of collapse.

Nothing could have demonstrated so clearly just how interconnected our financial systems are, and how exposed we are to risk originating elsewhere in the world.

In such a context, only a global response can bring about sustainable financial stability. However, change begins at home. Let me first re-cap what we are doing here in the EU to restore confidence and reform our financial markets.

EU Emergency measures to contain the crisis

Europe acted swiftly to avert financial meltdown. EU central banks, Member States and the Commission have worked hand in hand to break the cycle of asset write-downs, pressure on share prices and banking failures.

The European Central Bank, in coordination with central banks worldwide, has injected massive amounts of liquidity and has made aggressive interest rates cuts. Just last Thursday the ECB cut rates by an unprecedented 75 basis points.

At the same time, the majority of EU Member States have announced massive national schemes encompassing measures such as state guarantees, assets-swaps and asset-purchases in addition to capital injections, both through public and private money in a number of financial institutions.

The European Commission has quickly provided a framework to coordinate national rescue plans and has already approved the majority of the notified bank rescue plans through exceptional, accelerated procedures.

Where does this leave us today?

All those measures are gradually having an effect, as indicated by a moderate but sustained improvement in market stress, in particular in the money markets. However, even more worrying, the effects of the crisis are increasingly being transmitted to the real economy. The fragility of the financial system has serious consequences on the availability of credit and unprecedented increases of spreads.

The euro area, including Germany and Italy, has now been in a recession since the second quarter and the UK is expected to be during this quarter.

As for the United States, it has been declared in recession since December 2007. The recent survey and hard data also shows that the economic situation continues to deteriorate.

Against this background, the Commission on 26 November put forward an EU-wide Economic Recovery Plan bringing together a monetary and budgetary stimulus at both national and EU level notably including wide ranging investments to sustain demand and cushion the downturn.

EU finance ministers agreed at the beginning of December that decisive action is warranted and that a package of about 1.5% of the EU's GDP, combining national action and measures at the EU level, is necessary.

EU heads of government, who will meet in Brussels later this week, should endorse the Recovery Plan and the subsequent measures –at national and EU level- that restore confidence and jump-start the economy.

It is of utmost importance that EU members coordinate their responses to avoid a long and deep recession, the same way we were able to coordinate our actions to avoid a financial meltdown.

The Commission's Recovery Plan combines national budgetary stimuli, as I said, with EU action. The Commission proposed to Member States to prepare their Plans on the basis of a list of targeted measures on the revenue or expenditure side to provide immediate support towards investment and consumption that are at a standstill or falling.

The Commission will frame the monitoring of the fiscal stimulus packages within the Stability and Growth Pact, sticking to its rules and principles but, at the same time, making use of the flexibility introduced in 2005. We

need to ensure that the sustainability of public finances remains well anchored in the medium-term.

These actions should be coherent with our long-term objectives to contribute to fight climate change, improve energy efficiency and promote the use of cleaner energy in the EU, another crucial topic that will also be on the agenda of the EU leaders this week.

Therefore, the EU needs "smart investments" in the energy/climate change field. But we also need to focus on those infrastructure and other projects that will contribute to increasing competitiveness and growth potential, especially in those countries where they need it most, in line with the Lisbon Strategy for Growth and Jobs.

At the same time, we must put pressure on banks for them to continue lending to companies and households at affordable rates. Beyond restoring stability in the financial markets, this is what the capital injections and state guarantees intend to achieve.

If this does not happen and soon, it may be necessary to reinforce the conditionality attached to central bank lending or government intervention. We cannot risk a credit crunch that aggravates the economic downturn and puts thousand of people's livelihoods at risk.

We must also make certain that the various national measures are sufficiently consistent to maximise their combined impact. Above all, they must not adversely affect the single market and create distortions in competition.

The Commission has already provided comprehensive guidance on the application of EU state aid rules in October. We have now adopted a more detailed guide on how recapitalisation aid schemes should be constructed.

Regulatory reforms to restructure the European financial sector

Looking beyond the immediate challenges, we also need to re-structure the European regulatory framework and minimise the risk of future crises.

We have made progress. For over a year we have been working alongside Member States and with other international bodies to, among other things, increase protection for bank depositors, dissuade banks and other financial institutions from taking excessive risks in the future and better regulate rating agencies.

It is vitally important that we do not let the pace of this work slacken and that the proposals now on the table are rapidly adopted and implemented.

One of the highest priorities is to tackle the question of cross border supervision in a more comprehensive way than has been done so far in the discussions in the Council on Solvency II directive for insurance groups.

The High Level Group created under Jacques de Larosière will make its first report in the spring on this issue. I am pleased that it has chosen to take a broad perspective and to cover not only efficiency but also macro-financial aspects, such as ways to integrate macro-prudential and micro-prudential oversight.

Global effort to reform the international financial architecture

At the global level, we need to coordinate both the efforts to create a new international financial architecture but also, and more immediately, to put

the economy on a recovery path, as agreed at the G20 meeting in Washington. If there ever was a case and a need for Europe to be united, agree on a common position and speak with one voice it is now that we are facing the worse financial and economic crisis of living memory.

It is clear that with our highly interconnected financial systems, reforms will only be truly effective if they are implemented in a coordinated way at the European and global level.

Moreover, it is only through closer European and international cooperation that we can ensure measures taken in one country do not impact negatively on others.

The meeting of the G20 on the 15th November marked the first important step towards that enhanced international cooperation. Not only did leaders agree common principles for reforming our financial architecture, they also launched a detailed action plan to implement those principles.

These relate to strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets, reinforcing international co-operation and reforming international institutions.

This international agenda strongly reflects our roadmaps at EU level. Indeed, Europe was able to provide an important steer during the summit owing to the fact that we had agreed a clear and unified position ahead of the meeting.

It is now crucial that we remain at the forefront of efforts to improve global financial architecture. The EU is one of the two largest capital markets in the world. We have a strong interest to take a leading role in this reform process.

In particular, we will push for a more effective multilateral macro-financial surveillance system for the global economy. We recognise that the IMF has a pivotal role to play here. Given that the current crisis stems partly from macro-economic policy mistakes and the failure to prevent the build up of global imbalances, we urgently need a more vigorous and even-handed surveillance by the IMF for all countries, and a stronger collaboration between the IMF and the Financial Stability Forum.

I am also convinced that we need to reform the international governance framework so that it gives a more balanced representation of global economic and financial interests. This means strengthening the voice of the key emerging market economies in multilateral institutions to increase their legitimacy and effectiveness. In this respect, we must also consider a consolidation of our own representation.

The first step is to widen the membership of the Financial Stability Forum to include key emerging economies. The European Commission should also become a full member of the FSF, given its role in developing financial regulations within the EU.

I am confident that the process set in motion by the Washington summit, which was preceded by the adoption of a detailed road map by the ECOFIN in October 2007, will lead us to serious reforms in this area. The deadlines set for the various working groups and fact that the second leaders' summit is now scheduled for the 2nd April in London provides clear momentum for progress.

Conclusion

Ladies and Gentlemen, let me conclude.

Today, I have tried to show that despite the daunting and unprecedented challenges brought by this crisis, we are responding at all levels – national, European and global - to put the financial system –and our economies- back on a sound footing.

This crisis has made room for new thinking and new actions: on how we regulate our financial markets; on how we detect and manage macro-economic risk in the global economy; and on how we represent new interests in a changing global and financial landscape. This is a rare opportunity for real change. We must grasp it with both hands, and work together to build a more resilient global economy in the coming years.

Thank you for your attention.