

Christine Lagarde
12.09.08

Mr President,
Ladies and Gentlemen,

France has held the Presidency of the Council of the European Union since 1st July and will continue to hold it until the end of the year. It is at once an honour and a responsibility for our country to represent **the 495 million men and women living in the European Union**, who expect their leaders to show courage and capacity for innovation.

From tomorrow on, I will chair the **informal Ecofin Council**. At our invitation, the economy and finance ministers of the 27 European Union countries, the central bank governors, the European Commission, the European Central Bank, and the European Investment Bank will meet to review the economic and financial situation in Europe.

For the first time, a woman will chair the meeting. That is no doubt a sign of the progress made for the cause of women in Europe, but, judging by the number of dark suits surrounding me, it may also be taken as a sign of the progress that remains to be achieved.

In the difficult economic context we are now experiencing, I am convinced that Europe will be strong if it succeeds in expressing a common message. In the field of diplomacy, the role played by Europe at the initiative of the President of the Republic Nicolas Sarkozy in the cessation of hostilities in Georgia shows that **the voice of the European Union is heard when it is united**. The same applies in the economic sphere -- it is by putting across a common message that we will be able to respond effectively to the economic difficulties we are going through.

As regards this common message, I would like it to be centred on **three notions -- growth, confidence and convergence**.

(I) Growth

As we meet, Europe is experiencing a marked economic slowdown. Only a few months ago, we had the impression that the quality of our economic fundamentals would preserve us from the turbulence that arose on the other side of the Atlantic. Good figures for European growth in the first quarter appeared to confirm that impression. But marked slowing in world growth, the depth of the real-estate crisis in the United States, and the persistence of the financial crisis had a profound impact on our continent in the second quarter.

We are now undergoing **economic shocks of three kinds**.

- First, an **inflation** shock that has resulted from very steep rises in oil and food prices.
- Then there is the **exchange rate** shock that results from the euro's rise. This was particularly steep at the beginning of the year, but we are experiencing the full effects today.
- Finally, there is the **financial** shock with the consequences of the financial crisis that began in the United States last year.

Forecasters agree that **the slowdown in growth is likely to continue through to the end of the year**. In the United States, where growth has so far proved resilient, the favourable effects of tax cuts for economic activity and of currency depreciation for exports are likely to fade in the second half. The process of adjustment on the real-estate market is not yet complete and will continue to weigh on domestic demand for several quarters.

Does that mean that we are at the beginning of a prolonged phase of slower growth? I do not believe so. **Growth should pick up again in the euro zone next year**, with favourable factors including a significant decline in commodity prices, particularly oil, which suggests that the peak in inflation is behind us. The decline in the euro over recent months, assuming it continues, should provide significant support for our exports to other parts of the world.

In the face of these common shocks and the slowing that affects us all, it is my belief that **Europe must respond with a coordinated economic strategy**. Nothing could be worse, in my view, than to signal European division in responding to these shocks, or European immobility.

The absolute priority is the **continuation of structural reforms**. Those reforms have allowed the creation of 14.3 million new jobs in Europe over the past five years, bringing unemployment in the Union down to an historically low 6.8%. The same reforms, illustrated by the Act for the Modernisation of the Economy in France, will put downward pressure on prices through increased competition.

In this period of economic slowing, we also need to be very attentive to **financing terms for small and medium-sized enterprises**. SMEs account for 50% of European employment and growth. They are often more fragile and more dependent on bank financing. That is why I will tomorrow be putting a proposal to my colleagues in the Ecofin Council for us to mobilise the European Investment Bank to better meet the needs of SMEs.

(II) Confidence

My next key word is **Confidence**.

Our meeting coincides with **a turning point for international finance**. Over the past few days, financial markets have seen renewed strains coming shortly after the courageous and resolute action of the United States to facilitate stabilisation of the U.S. real-estate market. These developments reinforce, in my view, the need for coordinated action from the international community in response to market turbulence. It is on that condition that we will succeed in restoring confidence.

Back in October 2007, we adopted an action plan within the Ecofin Council to counter dysfunctions observed in markets. Implementation of that plan is central to the French Presidency's agenda.

The priority for the near term is **transparency**. Banks must be completely transparent as regards their losses and the risks. The half-year financial reports of the large European banks will show what progress has been made. There must be no concessions.

In July this year, at the first Ecofin Council meeting I chaired, we agreed on the registration and supervision of **rating agencies** at European level. Europe must play its full part in the regulation of these agencies. It is a subject that concerns all national supervisors in Europe. Over coming months, we will decide on the supervision structures in consultation with all stakeholders. I hope and expect that we will do this with special attention to consistency with the work of the International Organization of Securities Commissions, which must provide the common foundations for any regulatory initiatives.

We will also be working to **reinforce risk management**. Along with my colleagues in the Ecofin Council, we have launched a review of the so-called Basel II Directive (Capital Requirements Directive) with a view to making appropriate improvements to prudential rules. The aim is in particular to better allow for liquidity risk and risk relating to securitization.

Looking beyond the implementation of our action plan, a number of new contributions to the debate have not failed to attract our attention. I have sent on to my colleagues the **report on the financial crisis drawn up at the request of the President of the Republic by René Ricol**, the former president of the International Federation of Accountants. In coming months we will be looking at some of the issues emerging from this work. This evening, I would like to share two considerations with you.

Questions are being raised with growing insistence as to the **potentially pro-cyclical nature of the association of prudential and accounting rules and their application**. This issue needs to be considered in detail. We all find it natural that monetary policy and adjustments to that policy should be guided by signals from our economies with a view to preventing overheating or, on the contrary, sharp slowing. Similarly, we might have to envisage adaptation of prudential regulations to the macro-financial context with a view to preventing credit distribution or leverage effects from getting out of hand.

A second issue is the **compensation paid to market professionals**. The present crisis has highlighted the loss of the sense of responsibility that can result from current forms of compensation, which reward excessive risk acceptance but do not provide any penalties for losses. I do not think that the solution can come from government. But it is an issue that financial professionals need to deal with quickly, defining consensual rules to restore the trust of their fellow citizens. I know that you do show a sense of responsibility and ethical commitment, as we now see with the launch of the European micro-credit fund, rewarding the courage and conviction of Maria Nowak. It is my hope that you will also show that sense of responsibility and commitment to ethical standards in defining a code of conduct for the compensation of financial professionals.

As you will have understood, over coming months our action and our thinking will be focused on improving tools for the control and supervision of risk, to prevent new crises and better stand up to financial instability.

(III) Convergence

Which leads me up to my last key word -- **Convergence**.

Europe today suffers from the excessive fragmentation of financial regulation and supervision. Each country has its own supervision systems, its own disclosure requirements. This fragmentation is a risk factor in an environment where financial institutions are becoming larger and larger, more and more complex, and more and more international. It also makes for ineffectiveness -- financial groups have rationalised organisation of risk control and cash management. We have to do our part, and European supervisors must aim to be just as effective in keeping pace with these developments. Failing which Europe's consumers will pay the price for a system that is not sufficiently efficient and soundly based.

Which is why I propose to make **supervision** of cross-border groups a core theme for the work conducted under the French Presidency. It is a difficult subject since it requires transfers of competence, in particular as regards the supervision of financial groups. I call on you all to show political courage in working out innovative solutions with due consideration for the legitimate interests of all considered.

There is already a consensus on some points. **The Lamfalussy process** defines the way ahead -- there is no question of setting up a single European supervisory authority. I prefer to be perfectly clear about that.

We need to **reinforce the committees of supervisors**, whose role is to favour the uniformity of application in practice. To back this up at national level, supervisory authorities need to be given strong incentives to put the recommendations of the committees of supervisors into practice.

As regards financial groups, we need, firstly, **to reinforce coordination among supervisors.** Key prudential decisions concerning a group as a whole need to be taken under the aegis of the supervisor competent for the entity heading it up. This is essential for an efficient system.

Secondly, we need to **bring all the supervisors concerned into the process** to ensure proper equilibrium. European supervision must be collegial, involving all the relevant authorities in strategic discussion regarding a financial group as a whole.

This will be an important topic for our talks tomorrow. I trust that we will be collectively able to show ambition and political courage in this area. As Chair, I will be putting all my energy into **efforts to reach a balanced compromise.** In the end, financial institutions and European consumers all stand to gain. The time is ripe -- we must not pass up this opportunity to achieve new progress for Europe.

Our Presidency has an ambitious agenda, but it is also pragmatic. Above all, what I want is to achieve concrete results over the short period allowed for us to make our contribution to shaping the future of Europe. In this, today's debate will help us frame our thought and actions.

To apply that agenda, we have to work together, defining coordinated, ambitious responses to the challenges for our continent. I know that I can count on you, and I assure you that you can count on my determination to make a success of these projects.