INTERNATIONAL MONETARY FUND

Statement by the Managing Director to the International Monetary and Financial Committee on the Fund's Policy Agenda

April 13, 2011

Context. Since the IMFC last met, the global economic recovery has gathered strength and financial conditions have kept improving; but members continue to face multiple and diverse challenges—slow growth, high unemployment, and fiscal and financial vulnerabilities in many advanced economies; and rapid credit growth and overheating pressures in some emerging markets. Rising food and energy prices have returned, further constraining policies. Meanwhile, global imbalances show no sign of abating, and volatility in cross border financial flows and exchange rates remains high. The outlook has been further challenged recently by unpredictable shocks: the tragic events in Japan and developments across the Middle East and North Africa. The latter also contain an important lesson for policy makers, namely that the quality of growth—especially its ability to combat unacceptably high unemployment and inequality—is critical to the sustainability of growth.

Role of the IMF. Against this background**,** the need for cooperation to prevent instability and crises, and to contain their costs when they occur, is as evident as ever. This is the prime mandate of the Fund. A key question for the IMFC therefore is how can the Fund best discharge it? Important reforms to the Fund's surveillance and lending tools were undertaken in the immediate wake of the crisis, but it is appropriate to take stock and assess whether they go far enough given our gradually improving understanding of how the international monetary system (IMS) functions. In this regard, three aspects have become inescapable:

- The great extent to which policies in major economies, whether advanced or emerging, impact each other and the entire system.

- The importance and complexity of financial links connecting economies to each other, particularly as compared to real links; and the corollary that cross border financial flows have a major influence on the functioning of the IMS, making financial regulation relevant to the IMS as well.

- The essential role of access to international liquidity in times of systemic crises, to prevent localized stress from spreading and liquidity crises turning into solvency ones with much greater costs.

Surveillance and financial flows. Here, our immediate objective must be to improve the way we deal with cross border linkages. Much has been done since the crisis to strengthen the Fund's ability to identify potential vulnerabilities (e.g., through the early warning exercise and mandatory Financial Stability Assessment Programs for countries with systemic financial sectors, as well as closer monitoring of sovereign risk and policies to reduce related vulnerabilities). Work on addressing data gaps revealed by the crisis is ongoing, in collaboration with the FSB and other international institutions.

But a lot remains to be done to underpin better policy collaboration. In this connection, noteworthy steps are the "spillover reports" for the five major economies (U.S., Euro Zone, China, Japan and UK) that will be presented experimentally alongside Article IV discussions in the summer; and efforts to develop global "rules of the road" for policies having an impact on cross border financial flows. Analytical work undertaken over the past year led to endorsement by the Executive Board of a framework to inform policy discussions with member countries for considering how best to deal with capital inflows, including the use of macroeconomic policies, prudential measures and capital controls. It will be complemented in coming months by further work on the multilateral aspects of policies affecting financial flows in both recipient and source countries, including macroprudential policies, as well as work on capital account liberalization and dealing with outflows. Ensuring orderly global financial linkages can only be a shared responsibility of source and recipient authorities, who therefore need to collaborate—a process the Fund will strive to support. In addition, the Fund will continue to work toward improving the understanding and monitoring of financial interconnectedness and cross border flows, including by seeking to improve the availability of critical data.

The upcoming Triennial Surveillance Review will provide an opportunity to take stock of the broad range of recent initiatives and recommend further steps, including possibly to the legal framework for Fund surveillance.

Global liquidity. We must strive to put to rest lingering questions regarding the availability of international liquidity in times of systemic crisis. The precautionary lending tools created by the Fund during the crisis have significantly improved prospects for access to global liquidity for many countries, thereby reducing their vulnerability to sudden stops in market access. Analytical work on reserve adequacy has also yielded useful initial insights on the level of international reserves that countries might find optimal to hold for precautionary purposes. But questions remain regarding the sufficiency and composition of the overall financial safety net (including global, regional, and national components) to deal with systemic liquidity shortages. Indeed, in the recent crisis, the bulk of the needed liquidity was provided through ad hoc arrangements deployed on a one-off basis by key central banks. It seems desirable to explore formalizing more comprehensive liquidity provision arrangements, including via collaboration between the Fund and regional financial arrangements. Ongoing work on the role and composition of the SDR also holds the potential to improve mechanisms to provide global liquidity and diversify safe assets.

Low-Income Countries (LICs). Enabling higher growth while watching out for emerging vulnerabilities will be a key objective. Most LICs have recovered rapidly from the global crisis, but they are particularly vulnerable to the recent surge in food and fuel prices. The Fund will maintain its extensive engagement with LICs to assist them in addressing these shocks and rebuild their policy buffers, and is continuing efforts to secure adequate financing for its concessional facilities to LICs. The Fund will further strengthen policy support to LICs through continued efforts to enhance cross-country analysis. In this connection, the Fund's new Vulnerabilities Exercise for LICs will allow closer monitoring of their vulnerabilities in the face of continuing shocks. The Fund's ongoing work to improve the debt sustainability analysis framework will also provide tools to support growth-enhancing public investment while safeguarding debt sustainability.

Governance. We must preserve the strong momentum arising from the recent entry into effect of the 2008 reforms and adoption of a new historic package. Last Fall's agreement on quota and governance reforms was a major milestone in realigning the Fund's governance structure with global economic realities. Implementing it by the 2012 Annual Meetings, as members have committed to strive to, will be essential to the Fund's continued legitimacy.

Conclusion. The crisis taught us that cooperation is essential to stability. As the global economy continues to recover, we cannot allow cooperation to simply fade away. The interconnectedness of the global economy implies global interests and national interests are mutually reinforcing. Continued collaboration is therefore necessary to ensure globalization remains a positive force in the world economy. Effective processes are needed to underpin it. The IMFC can help guide their design in a way that commands the broadest support from the membership.