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Statement by His Excellency, Sultan Bin Nasser Al-Suwaidi
Governor of the United Arab Emirates Central Bank
On behalf of Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libyan Arab Jamahiriya, Maldives, Oman, Qatar, Syrian Arab Republic, United Arab Emirates, Republic of Yemen

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The Global Economy and Financial Markets—Outlook and Risks

Since our last discussion in October 2004 of the World Economic Outlook, the pickup in global economic activity, which was then evident, continued to strengthen in recent months and has covered most regions. A robust, and above trend, rate of growth was achieved by the United States. China, which has become a second engine of growth, and an important player, not only in Asia but also globally, maintained its traditional high-growth rate of the decade, thereby adding to the global growth momentum. In this environment, many countries have continued to introduce and implement solid reforms, particularly in the fiscal, monetary, and exchange rate areas. It is also heartening to see a growing recognition by many member countries that structural reforms, in particular economic institution building, have an important role in entrenching and sustaining growth. These developments will certainly render the global economy more resilient to shocks. The anemic growth of Japan and the euro area stands in stark contrast to that of the United States and China. The emerging markets of Asia, the Middle East, and Latin America however have logged in a respectable growth record. We are also happy to note that, by and large, low-income countries recorded healthy rates of growth but poverty is unfortunately still stubbornly prevalent. The global growth is generally expected to continue into 2005 but at a more subdued rate. These developments were attained in a historically generally low-inflation environment throughout the globe. Moreover, financial crises were particularly noteworthy by their absence.

In spite of these favorable trends, a number of factors lead us to believe that the down-side risks to the outlook appear to be on the rise since our last meeting six months ago. These risks are, for the most part, emanating basically from the twin deficits of the United States and the imbalances in growth between regions. In the United States, the current account deficit continues to increase and could well reach 6 percent of GDP by the end of this year, and is not expected to decline anytime in the near future. The high budget deficit is also a concern. The fact that the sizable budget and current account deficits have existed for some time without contributing to any crises could well render policy makers, and possibly regulators, more complacent. These high deficits could have serious global ramifications on the real and financial sectors.

As we have repeatedly noted in past years, it would be a mistake to argue, as many do, that the U.S. current account deficit is primarily a concern for the country's policy makers only. The deficit should be viewed from a global perspective and not only as a homegrown problem. An abrupt depreciation of the U.S. dollar forced by the markets could be disruptive and very damaging to the world economy. Interest rates could rise sharply thereby slowing down the global economy and creating difficulties for emerging market finances, asset prices could descend from their lofty levels further aggravating the economic slowdown. This chain of events could be self-reinforcing and easily and quickly transmitted to the global economy.

Policies to address these imbalances at a global level are therefore called for. They were also called for in this forum last year. The need to address structural reforms to enhance the sluggish growth in the euro area has been the subject of discussion in both bilateral and multilateral surveillance, and although a beginning has been made in introducing needed reforms, particularly in Germany and France, these reforms remain short of what is required. In spite of the slow pace of growth in the euro area, there are hopeful signs that household demand and investments are beginning to pick up in the major countries of the region. In Japan, there is a pressing need to address the problems of the banking and financial sectors and embark on a medium-term strategy to reduce the fiscal deficit and help correct the recurrent stop-and-go cycle of economic growth of recent years, which has created uncertainties that are not conducive to sustained growth. Additionally, the introduction of flexible exchange rates, in those countries where institutions and financial infrastructures are adequately developed, have a role to play in correcting the imbalances.

We are happy to note that the Fund is in the process of selectively tailoring its surveillance to key issues facing the membership individually. It is our hope that the Fund will play a leading role in coordinating with key players a program of corrective actions to address the current account deficit on a global basis. This falls under one of the basic mandates of the Fund—the promotion of a stable economic environment. This coordinating and proactive role could be an integral aspect of the Fund's medium-term strategy. The current situation cannot last forever. Creditors of the United States, particularly if the dollar continues to depreciate, may well demand higher interest rates. We are hopeful that the membership will attach high priority to this issue.

The rather long period when the Federal Reserve pursued an overly accommodative monetary stance to combat a possible deflation and avoid the recessionary conditions, that were evident some three years ago, coupled with the stimulus provided by budgetary policy, may have been appropriate at that time but are not without adverse consequences. This accommodative stance contributed to a sizable increase in the net worth of households, mainly in the real estate and equity sectors. Additionally, the easy monetary policy gave rise to increased borrowings, through refinancing of mortgages and equity borrowing, boosted consumption of economic agents, including in particular households, and national savings were virtually non-existent. Another consequence of the low interest rate policy is the increase in risk appetite, which is evident particularly in the financial sector. We are told that risks have now been pushed to the household sector which is probably the least equipped sector to address these risks. A sharp increase in interest rates could well role back the increase in the net worth of households, which appears to be one of the factors sustaining the high consumption levels. National savings, which are historically low, may begin to rise and the economic slowdown may set in the short run. To be sure, an increase in household savings will play a role in reducing the current account deficit.

The transition towards a more neutral monetary policy stance began some ten months ago when the Federal Reserve initiated a cycle of periodic tightening. The fear at the time was that this transition to higher interest rates would have an adverse impact particularly on emerging market capital flows and debt sustainability. Fortunately, so far, the transition has been proceeding relatively smoothly. However, the cycle of rate increases has not been completed yet and the risks to financial stability and growth are still high, particularly if inflationary pressures lead the U.S. monetary authorities to increase interest rates more sharply than is implied by the “measured pace” approach. The budget deficit would further add to price pressures. While the accommodative monetary policy is being tightened, the budget deficit continues to be a source of concern and could add to interest rate pressures. The plan to cut in half the U.S. budget deficit in the next five years is neither sufficient nor credible. What is needed in the United States is a policy mix directed at increasing both household and public savings. While such policies may contribute to an initial drag on economic activity, they are an important input in promoting policy credibility and long-run growth prospects both globally and for the United States.

Medium-Term Strategy for the Fund

We welcome the initiation of work on a medium-term forward looking strategy to guide the institution’s work program over the medium term. For this strategy to be successful, we need to pay particular attention to the size of the Fund. Accordingly, we should exercise a high degree of selectivity in the content of the institution’s work which in recent years has expanded rather sharply. More focus and depth in priority areas that are relevant to the problems of a member country are called for. We must also seek an operationally clearer definition of what constitutes the core activities of the institution. Within these core activities, we need to set our priorities. The Fund should help members put in place robust economic institutions in areas of its expertise. We are very much against any involvement, direct or indirect, in the area of the so-called “broad institutions”, which involve in many cases political aspects and encroach on a member’s sovereignty.

The Fund needs to take action to further enhance its instruments to address crisis prevention in a world in which many countries have become increasingly open to international capital flows. This has heightened the risks of large and sudden movements in capital flows that we have experienced in recent years in several countries. These circumstances call for a more effective instruments to address such potential disruptions that could generate costly and serious financial crises. The Fund should look carefully into establishing a precautionary facility that provides preventive financial assistance to assist countries pursuing appropriate policies to avoid such crises. The existing precautionary arrangement was designed to prevent current account crises. What is needed now is an arrangement tailored to prevent capital account crises. We believe this to be a high priority.

Support for Low-Income Members Towards Poverty Reduction and Strong Sustainability Growth

Five years after the Millennium Declaration and within a few month of *United Nations Summit Conference on Implementing the Millennium Development Goals*, we are now at an important juncture with regard to the progress on poverty reduction and the enhancement of living standards in LICs. There is a broad consensus that, without a much stronger and timely mobilization of resources and the actualization of commitments, the MDG goals for 2015 will be largely missed in many countries. Indeed, the five year stocktaking exercise on the MDGs reveals a mixed record at best, with a deteriorating situation particularly in sub-Saharan Africa. However, the positive record in Asia—in China and India in particular—should provide us with important lessons in order to replicate their successes elsewhere.

It is, therefore, clear that the Fund needs to remain actively engaged with the LICs, providing financial and technical assistance—within its core areas of competence—to assist LICs achieve sustainable growth and poverty reduction, as well as analytical input in the formulation of appropriate strategies. Doubtless, the critical conditions for developmental progress rest in the formulation and implementation of sound policies and the strengthening of key economic institutions in the countries themselves. However, without steady donor contributions, in many instances, these measures will not be enough to provide the adequate impetus for progress.

Given the large financing gap (estimated at least at US$50 billion annually) to meet the requirements for the attainment of the MDGs, we repeat our call on industrialized countries to strive for the achievement of the UN target on ODA. Moreover, many imaginative proposals for mobilizing resources for sustainable development have recently been made by different agencies in the donor community and the multilateral institutions. Due consideration must be accorded by the Fund to the various proposals on innovative financing mechanisms being debated in various international fora, including in the Second High Level Forum on Aid effectiveness held in Paris in March. The momentum needs to be used to develop sound approaches with a realistic chance of being implemented. It would be particularly important to do so before the September 2005 United Nations conference.

All the proposed options deserve to be explored, including enhancing voluntary contributions, establishing a framework to facilitate remittance flows, creating the International Finance Facility, introducing Global taxes. Moreover, further debt relief could also be considered, as one element of the broad development assistance agenda, to ease the LICs' external financing constrains and improve debt sustainability. Of particular importance in this regard, is that debt relief should not substitute for direct contributions by donors, but should instead be part of an expanding overall aid envelope, and the composition of aid should continue to shift towards more concessional loans and grants.

For the Fund, bilateral contributions should be the basis for any debt relief, and the Fund could adopt an active role in raising such contributions and coordinate closely with donors in this regard. It is critical that the Fund's financial capacity to assist LICs through the provision of concessional assistance in the context of the PRGF and the implementation of the enhanced HIPC initiative not be weakened. Therefore, we do not favor drawing upon the resources of the PRGF Trust. The option of using the Fund's gold holdings could be contemplated in case of insufficient bilateral contributions to reach the envisaged debt relief levels, after a careful assessment of the impact of the procedure on the Fund's financial position.

Finally, a strategy for LICs should allow them to take advantage of their comparative advantages on a global scale. In this respect, We deem it important that an outcome supportive of developing countries be achieved in the Doha round. A reduction of subsidies in industrial countries, in particular following the WTO ruling on cotton subsidies, would contribute to broad based growth in LICs.

Turning to the Middle East region, the past year has witnessed an increase in the pace of reform, which for some countries was helped by the increase in oil prices. But even in the non-oil producing countries, widespread reforms are being addressed, including trade and tax reform, and measures to create a better environment both for institution building and higher quality of education to accommodate the needs of a changing world economy. In some countries, important time-bound steps have been taken to restructure the banking system and step up the pace of privatization in this sector, as well as in other non-financial public holdings. The region is thus poised for a more meaningful integration in the world economy. As a result of these reforms, real growth in the region as a whole is in the vicinity of 5 percent last year and is expected to continue into the current year. Equity markets in many countries have reached new historic highs. These developments took place during a difficult regional setting. The challenge facing a number of the countries centers around maintaining the pace of reform, reducing public debt where it is uncomfortably high, continuing to promote governance, and building institutions. Action in these areas would be crucial to the maintenance of the momentum of growth. As the peace outlook improves, the countries in the region are determined to move ahead with needed reforms to create an environment conducive to sustained growth and job creation.

Finally, we would like to reiterate our gratitude to the Fund for the technical assistance provided to Iraq and Palestine. We would like here to stress that a durable improvement in the region's stability and economic outlook requires a return to peace and prosperity in Iraq and Palestine. The international community should do its utmost to promote peace and mobilize aid to these two countries to end the suffering of their people. We welcome the important role of the Fund in the provision of technical assistance and in coordinating donor aid to Palestine, and in supporting the development effort in Iraq in the context of the Emergency Post Conflict Assistance program.