PRELIMINARY

ECOSOC 2009 High-Level Segment

High-level policy dialogue with the international financial and trade institutions on current developments in the world economy

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Speaking Notes for Mr. Murilo Portugal
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Your Excellency Ambassador Sylvie Lucas, President of ECOSOC
Secretary General Ban Ki Moon
Under Secretary General Sha Zukang
Excelencies
Ladies and Gentlemen

It is a great pleasure to be participating once again in this High Level Policy Dialogue and bring you the International Monetary Fund views on current developments in the world economy. I would like to give you the IMF updated outlook for the global economy and report to you the main initiatives and policy actions that the IMF has taken to help our member countries to deal with the international financial crisis and the global recession it generated.

A. Overview of Global Economic Prospects

Following a steep decline in global output in the last quarter of last year and the first quarter of this year, signs are emerging that the rate of decline in global activity is moderating, but the timing and pace of a durable recovery remain still uncertain. Progress in returning the financial sector to health will be key.

- The updated Fund's projections for global growth for 2009-10 that will be released in the coming days will reflect a modest improvement for 2010, after the projected contraction of 1.4 percent in 2009, we are envisaging an expansion of 2.5 percent of the global in 2010 which is somewhat better than our April projection of a 1.9 percent growth for the world economy. This reflects improving prospects in emerging Asia, specially China and India, and the United States. However, the global recovery will be fragile, with risks tilted to the downside.
- Inflation will likely remain contained and upward pressures are not on the horizon, as output gaps continue to widen.

High-frequency data point to a return to modest growth at the global level. However, the recession is not over and the recovery is likely to be sluggish. The advanced economies as a group are still projected not to show a sustained pickup in activity until the second half of 2010.

Growth in emerging and developing countries will vary across countries and regions, with those more dependent on external bank-related capital flows being the most affected. Against a backdrop of weak external demand and tight external financing conditions, the projected modest growth recovery will be led by countries where domestic demand has the greater momentum, including from policy stimulus.

Policy interventions have helped conditions to improve financial markets, but the situation remains far from normal.

- In advanced economies, public intervention has helped reduce fears of systemic events, and equity markets have recovered some losses. However, impaired assets are still on bank balance sheets, and the adequacy of bank capital remains a concern.
- External financing constraints on emerging economies appear to have eased but conditions remain fragile.

Overall there remain serious risks:

- Financial strains could be protracted, particularly if efforts to deal with problem assets and to boost capital are not followed through forcefully, and loan performance continues to deteriorate.
- A loss in confidence in public finances over the medium term in countries that expanded debt and deficit substantially due to the crisis could lead to higher borrowing costs for both sovereigns and private sector, constraining growth.
- Trade and financial protectionism continues to be a concern.

B. Policy Challenges and Exit Strategies

The main policy priority remains restoring financial sector health. Macroeconomic policies need also to stay supportive, but start preparing the ground for an orderly unwinding of extraordinary levels of public intervention. At the same time, policies in systemic countries need to facilitate a rebalancing of global demand from key current account deficit to surplus countries.

Credible exit strategies will be needed to unwind substantial public interventions in an orderly fashion, when market conditions permit and the recovery becomes firmly established.

- This will require coherent sequencing and clear communications by both fiscal and monetary authorities.
- **Multilateral coordination** is likely to be needed to mitigate cross-border distortions during exit.

As I said, the medium term path for the global economy is likely to involve a rebalancing of the sources of demand, and policy frameworks of systemic countries should facilitate this shift to sustain strong global growth.

- Both private and public savings will need to rise in the advanced economies for a sustained period to repair damage to balance sheets.
- In major economies reliant on export-led growth in recent years, policy frameworks should adjust to become more supportive of domestic private demand. Greater exchange rate flexibility in some economies could also support the rebalancing of domestic and external sources of growth.
- Labor market reforms to enhance flexibility and mobility would help speed the reduction in unemployment; while reforms in product and services markets to strengthen competition and productivity could help mitigate the effects of tighter investment financing.

C. The IMF's Response to the Crisis

I would also like to provide you a broad overview of our activities and the many steps the IMF has taken to help member countries deal with the effects of the crisis in our lending, surveillance and policy advice functions.

Lending Function

- **We have substantially raised lending; reformed and increased the flexibility of lending framework; and undertaken a major advocacy effort to expand our financial resources,** so as to enable us to respond to the strong increase in the demand for lending:
    - Lending commitments are now more 11 times bigger than in the pre-crisis period, standing at a record level of close to \$160 billion, which compares with \$14 billion at end-2007 and \$86.2 billion committed in 1998 in the wake of the crisis in Asia.
    - In parallel, we have undertaken a **major overhaul of our lending framework: we** introduced a quick-disbursing facility without ex-post conditionality for strong-performing countries that borrow in international capital markets; we broadened the availability of high-access precautionary credit, and we discontinued structural performance criteria for all IMF loans. For low-income countries, we are significantly increasing concessional lending, continuing debt relief initiatives, and working to reform our lending policies to allow for more flexible, short-term, precautionary, and emergency financial assistance to these countries.
    - Program design in our financial assistance has been also adapted to the current global crisis circumstances: recent programs in crisis-affected countries provide **for higher social spending, strengthening social safety nets, and better targeting of existing social protection systems.** Wherever possible, the IMF has relaxed fiscal policy in low income countries during this recession; fiscal targets were loosened in close to 80 percent (18 out of 23) of African countries with an active IMF program, and about a

third of programs in LICs include floors on social and other priority spending. Also, inflation objectives in were substantially relaxed during 2008 as world food and fuel prices rose.

- As you know, shareholders have agreed to a **tripling of the resources available to the IMF to $750 billion; and a doubling of the IMF's concessional lending capacity**.

- Also, the membership is considering to inject $250 billion into the world economy to **increase global liquidity and international reserves** through a new general allocation of "special drawing rights," or SDRs. The Executive Board of the IMF discussed this topic last week of June and supported a prompt allocation as a collaborative response to the crisis, meeting the long-term need for supplementary reserve assets.This will increase the reserves of low-income countries by US$ 19 billion, acting as a low cost buffer for these countries and allowing some scope for sustainable counercyclical policies. The Board expects that the allocation will become effective by end of August.

Policy advice

In addition to its lending functions the IMF has provided policy advice to its members both advanced and developing countries on how to best cope with the crisis.

- Our policy advice for dealing with this crisis focuses on two main areas: financial sector policies to stabilize the financial sector and reestablish the flow of credit in the economy; and a relaxation of monetary and fiscal policies--where possible--to help to sustain aggregate demand.
  - **Support for financial sector restructuring was and remains the top priority** that we have advocated consistint of three types of measures:
    - provision of adequate liquidity to financial institutions--and central banks have been very successful in this task;
    - action to cleanse banks' balance sheets, by removing or isolating toxic assets; and
    - recapitalization of viable banks and resolution of non-viable institutions, on both of which fronts more still needs to be done.
  - We have also advised **expansionary monetary and fiscal policies** to support aggregate demand for countries that have low and sustainable debt positions and acess to financing to do so. We have stressed that policies in these areas should be closely coordinated internationally to maximize their impact and reduce spillover losses.
    - at the same time as countries adopt short-term fiscal stimulus, we also advocated countries should **announce now measures to deal with long term fiscal problems such as those related to aging populations, pensions, increasing health costs.** Such policies would not have any negative effect on current

aggregate demand as they are usually phased in gradually and would help to anchor expectations regarding long term fiscal sustainability.

- It is important to note that **we have recommended that all countries in a position to do so, should engage to the extent possible in counter-cyclical measures.**
    - Naturally, the advanced and larger emerging markets maybe better placed to pursue stimulus packages, given their greater acess to finance, but several developing countries have also been able to use their available fiscal space to take important measures to support demand.
    - However, many others will need scaled-up concessional assistance to ensure that their higher deficits do not lead to a worsening of their debt situations.

D. Lessons for the Future of the International Financial System

In addition to lendint and policy advice, the IMF engaged together with other international organizations in a careful analysis work of the causes of the present crisis. We have identified critical areas for reform of the international financial architecture. These issues have been discussed in many different fora, including at the G-20 Summits in Washington and London, so there is no need for me to go into specific detail here. The priorities include

- **Reforms of the system of financial regulation and supervision in advanced countries.** The priority is to ensure that regulation and supervision cover not only risks posed to an individual financial institution existence but all potential sources of systemic risk arrising from institutions, markets and products that are systemic. The IMF has started to work with the BIS and the FSB to define guidelines to help to identify systemic institutions and to identify tools to deal with them in an internationally consitent way.

- It is also important to effectively oversee cross-border transactions, with careful international coordination of national regulation, oversight, and resolution frameworks.

- During this exercise to strenghten surveillance it is important that the trends towards both **globalization and innovation are preserved** since these trends have been the majors sources of dynamism in the global economy over the last decades.

- **A second area of concern with respect to improving the international financial architecture is to improve and make more effective the international surveillance** of countries' economic and financial policies and of the global economy. Surveillance must identify better the sources of systemic risk, assess macro-financial linkages and spillover effects across countries. The Fund is trying to strengthen its surveillance framework. We are developing an early warning exercise to apply to systemically important countries to deal with tail risks to the global economy and plan to present such proposal next October during our Annual Meeting in Istambul. We are also reviewing our Financial Sector Assessment Program including to improve surveillance over regulatory frameworks.

E. Governance reforms

- **The crisis has also prompted several pleas towards reform of international economic governance, including governance of international financial institutions.** We support efforts to strengthen global governance and think they should be based on three important principles: pragmatism, specialization and division of labor, and effective institutional cooperation amongst international organizations.

  - *Pragmatism* seems to suggest that it might be more doable to reform and enhance existing institutions rather than creating new ones. This is important not only because it is very difficult to mobilize consensus to create new organizations but also to avoid wasteful duplication.

  - *Specialization and division of labor* amongst international organizations is also important to increase efficiency. So reform efforts should take into account the relative expertise and experience in specific areas and comparative advantages of each international organization in order to generate greater overall efficiency.

  - *But it is also essential to have effective institutional cooperation amongst international organizations* because problems are multifaceted and interlinked, and cooperation should be based each institution's mandate and governance structure.

F. Reforming the governance of the IMF

Let me give you a sense of what we are doing in the IMF this area of governance and tell you what our plans are:

- We had started to worry about improving our governance structure even before the crisis had started and have made some progress in this area since 2006. We will be **accelerating the implementation of a package of reforms adopted in April 2008.** These reforms include a rebalancing the IMF's quota shares to reflect better the relative positions of countries in the evolving world economy, and to give greater weight to the more dynamic emerging market economies. We have modernized our quota formula, trebled the number of basic votes, and approved ad hoc quota increases for the most dynamic emerging market economies. These reforms imply a shift of 2.5 percentage points of voting power in favor of developing countries. Our members have agreed to bring forward a further review of quotas by January 2011.

- Ideas are also being considered for achieving a more interactive and effective **participation of ministers and governors in providing strategic direction on key issues**. With increased globalization of trade and finance, there will be an increasing number of problems that would not have an optimal solution at the national level. Solving such problems may require greater international collective action and closer coordination of macroeconomic policy across countries than before. The IMF is a global inclusive international organization comprising of 185 member countries. Its Articles of Agreement envisage that it should be a major forum for international cooperation amongst countries in monetary and financial issues. It may work as a facilitator of such international collective action and several ideas are been discussed for a a reinvigorated IMFC that could play such role.