

IMFC welcomes plans to ease global imbalances

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The world's top economic and financial leaders, in Washington April 14–15 for the Spring Meetings of the IMF and the World Bank, welcomed policy plans from the biggest economies to reduce hefty global current account imbalances. They supported steps being taken to implement a package of IMF reforms, including measures to modernize surveillance, give developing countries more of a say in running the institution, and revamp the Fund's income.



Eugene Salazar/IMF Photo

Economic outlook is bright across the globe

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In Asia, Africa, Europe, and Latin America and the Caribbean, the economic forecasts are pretty much the same: growth is strong, especially in China, and will continue, and inflation is mainly under control. The regional economic forecasts prepared by the IMF all caution that a sharper-than-expected decline in the United States could dampen growth, but are upbeat about regional prospects. Even so, at current rates Africa will fail to reduce poverty enough by 2015 to reach its Millennium Development Goals.



Reuters

IMF, donors pledge to assist Lebanon

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In early 2006, poised for economic recovery, Lebanon outlined reforms to reduce its debt and financial vulnerabilities. But a conflict with Israel in July has made achievement of these goals difficult and forced the government to adapt its strategy. In 2006, the overall fiscal deficit widened, partly to accommodate reconstruction spending. To aid Lebanon in its recovery, the international community has pledged \$7.6 billion in grants and loans, and the IMF has approved a \$77 million loan in the form of Emergency Post-Conflict Assistance.



Gero Bimber

United Kingdom enjoys fruits of reforms

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The U.K. economy is harvesting the fruits of two decades of sustained labor and product market reforms to reap the rewards of globalization. Anchored by sound monetary and fiscal policy frameworks, the United Kingdom has also been able to respond flexibly to shocks. At the same time, energy price increases have boosted inflation, which in turn has pushed up inflation expectations to their highest level in years. If last year's energy price increases push up pay deals, the Bank of England (right) may need to further increase interest rates.



Newscast Images

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What's on

APRIL

25–26 World Economic Forum on Latin America, “The Power of a Positive Regional Agenda,” Santiago, Chile

25–27 United Nations Economic Commission on Europe, 60th anniversary session, Geneva, Switzerland

MAY

2–3 Bretton Woods Committee seminar, “10 Years after the Asian Financial Crisis, Asia’s New Responsibilities in the International Monetary System,” Seoul, Korea

IMF Executive Board

For an up-to-date listing of IMF Executive Board meetings, see www.imf.org/external/np/sec/bc/eng/index.asp

4–7 40th Annual Meeting of the Board of Governors of the Asian Development Bank, Kyoto, Japan

6–8 G-8 Labor and Employment Ministers’ Meeting, “Shaping the Social Dimension of Globalization,” Dresden, Germany

9–14 IMF High-Level Seminar on Macroeconomic Management and the Japanese Experience in Economic Development, Tokyo, Japan

14–15 OECD Forum 2007, “Innovation, Growth, and Equity,” Paris, France

14–23 World Health Organization, 60th World Health Assembly, Geneva, Switzerland

16–17 Annual Meetings of the Governors of the African Development Bank Group, Shanghai, China

18–19 G-8 Ministerial Meeting, Schwielowsee, Germany

20–21 European Bank for Reconstruction and Development, Annual Meeting and Business Forum, Kazan, Russia

24–25 World Conference on Intellectual Capital for Communities, Paris, France

30–June 15 96th Session of the International Labor Conference, Geneva, Switzerland

JUNE

6–8 G-8 Summit, Heiligendamm, Germany

18–July 21 The International Economic Forum of the Americas, “Succeeding through Uncertainty: From Risk Evaluation to Strategic Decision,” Montreal, Canada

JULY

6–8 Cercle des Economistes Seminar, Aix-en-Provence, France

AUGUST

19–23 8th International Congress on AIDS in Asia and the Pacific, Colombo, Sri Lanka

New Perspectives on Financial Globalization IMF, Washington, D.C., April 26–27, 2007

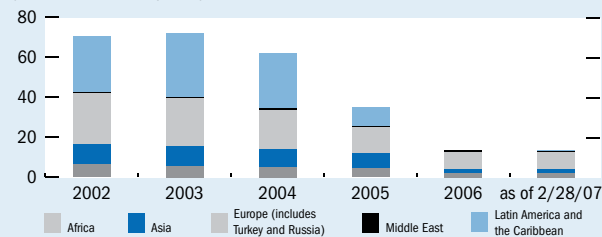
The conference, sponsored by the IMF’s Research Department and Cornell University, aims to provide a forum to present recent theoretical and empirical research on the macroeconomic implications of financial globalization.

For details, see www.imf.org/external/np/seminars/eng/2007/finflo/042607.htm.

IMF financial data

Total IMF credit and loans outstanding, by region

(billion SDRs, end of period)



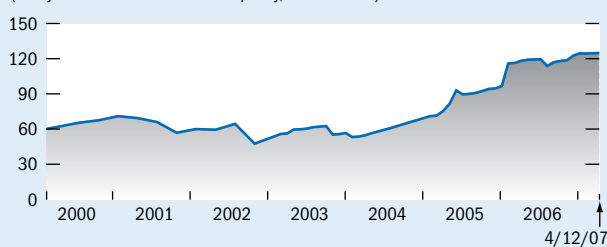
Largest outstanding loans

(billion SDRs, as of 3/31/07)

Nonconcessional		Concessional	
Turkey	5.62	Pakistan	0.93
Ukraine	0.46	Congo, Dem. Rep. of	0.55
Dominican Rep.	0.33	Bangladesh	0.32
Iraq	0.30	Georgia	0.16
Sudan	0.27	Yemen, Rep. of	0.14

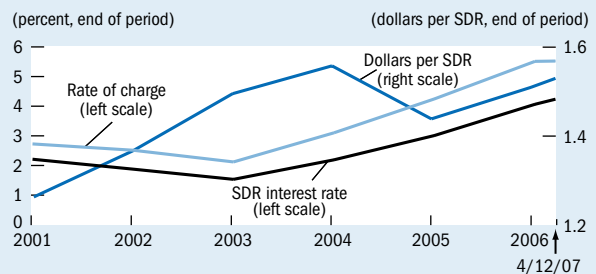
Available IMF resources

(one-year forward commitment capacity, billion SDRs)



Related rates

SDR interest rate, rate of charge on IMF nonconcessional loans outstanding, and dollars per SDR



Note: Special Drawing Rights (SDRs) are an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas. The SDR also

serves as the unit of account of the IMF and some other international organizations. Its value is based on a basket of key international currencies.

IMF–World Bank Spring Meetings IMFC welcomes plans to curb global imbalances

Against the backdrop of a bright global economic picture, the world's top economic and financial leaders—who gathered in Washington April 14–15 for the Spring Meetings of the IMF and the World Bank—welcomed policy plans from the biggest economies to reduce the hefty global current account imbalances. They also backed steps being taken to implement a package of IMF reforms, including measures to modernize surveillance, better prevent financial crises, and give developing countries more of a say in running the institution.

The International Monetary and Financial Committee (IMFC), the policymaking committee of the IMF's Board of Governors, welcomed the “continued strong, broad-based expansion of the global economy” and the greater balance in growth among regions. But it warned that “downside risks requiring continued vigilance arise from the possibility of a reassessment of risks in global financial market conditions, of a sharper-than-expected slowdown in the U.S. economy, and of a revival of inflationary pressures as output gaps close or if oil prices rebound.” The IMF is forecasting growth of 4.9 percent in 2007 and 2008, down from 5.4 percent in 2006, according to its latest *World Economic Outlook*.

Box 1

A plan for action on global imbalances

The five parties in the multilateral consultations outlined the following goals aimed at making further progress on an orderly unwinding of global imbalances in the years ahead:

China plans to reduce its external imbalances; boost domestic demand, particularly consumer demand, and rebalance investment and consumption; further promote balanced external sector development; speed up financial reform; and further improve the exchange regime “in a gradual and controllable manner.”

The euro area plans to further reform the product, labor, and financial markets.

Japan plans to reform the labor market, facilitate foreign direct investment in Japan, strengthen competition in key sectors, and further advance fiscal consolidation.

Saudi Arabia plans to increase spending on social and infrastructure investments and on expanding oil sector capacity.

The United States plans to further fiscal consolidation over the medium term; reform the budget process to contain spending growth; reform entitlement programs to strengthen long-term fiscal sustainability; adopt tax incentives to support private saving; increase energy efficiency; promote pro-growth, open investment policies; and improve capital market competitiveness.



IMF Managing Director Rodrigo de Rato (left) and IMFC Chairman Gordon Brown, U.K. Chancellor of the Exchequer.

Reducing global imbalances

Over the past year, the IMF has convened several rounds of multilateral talks aimed at sustaining world growth while reducing, over the medium term, global imbalances generated by the large U.S. trade deficit; surpluses in China, Japan, and oil-producing countries; and the need for structural reform in the euro area to boost economic growth. In a report to the IMFC on April 14, participants in the talks—China, the euro area, Japan, Saudi Arabia, and the United States—provided detailed policy plans elaborating steps already taken and those anticipated to support the IMFC's strategy, adopted in 2004, to reduce global imbalances (see Box 1).

IMFC Chairman Gordon Brown, the U.K. Chancellor of the Exchequer, hailed the report as “a major advance” on a huge issue that has worried policymakers for many years. “The willingness of the participants to make commitments about the future is important in itself.” IMF Managing Director Rodrigo de Rato said that the multilateral consultations were a welcome process, one that would not have been possible “outside a multilateral institution like the IMF.” He added that if these policies are put into place, there will be significant effects on reducing global imbalances, not only for the five economies but also for the rest of the world. In fact, IMF First Deputy Managing Director John Lipsky told reporters on April 19 that policies outlined by the countries, if implemented, could reduce global imbalances by 1.0 to 1.75 percent of world GDP over the next four years from a baseline of about 6 percent—in other words, relative to what would be happening without these policy measures.

As for the risk of rising protectionism, the IMFC—which was briefed by World Trade Organization Director-General Pascal

Lamy—welcomed the resumption of the Doha Round of trade talks and called on members “to work with a renewed commitment to urgently achieve an ambitious outcome.” Brown told reporters that “leadership and courage” were now needed to reach a solution and that rich and poor nations alike stand to benefit from a successful round. He noted that Lamy had stressed the importance of an aid for trade package so that developing countries would be in a position to benefit from a trade accord by having funds for infrastructure improvements almost immediately. At the Spring Meetings, the Group of Seven major industrial countries said that it would make \$4 billion available by 2010 for this purpose.

Progress on IMF reform

Another major focus over the weekend was how the IMF was progressing on its reform agenda—known as the Medium-Term Strategy—which was launched a year ago to enhance the IMF’s effectiveness and legitimacy. Both Brown and de Rato stressed that it was very clear that progress was occurring on all fronts.

Surveillance. The IMFC welcomed steps being taken to “strengthen and modernize IMF surveillance to ensure its effectiveness as globalization deepens.” It also called on the IMF Executive Board to continue to give priority to further work on all aspects of this reform, including updating the 1977 Decision on Surveillance over Exchange Rate Policies. It said the goal should be to “improve the quality of surveillance, its focus, candor, and evenhandedness.”

But statements from Fund members underscored the wide range of viewpoints on this issue. U.S. Treasury Secretary Henry Paulson insisted that, “for the IMF to remain modern and relevant, it must reinvent itself. . . . First and foremost, the

“Fulfilling aid commitments such as those made at Gleneagles in 2005 is a very important prerequisite to create sufficient space for high social and infrastructure investment.”

—Rodrigo de Rato

IMF must fundamentally reform its approach to surveillance over exchange rates. Let us be clear: exercising firm surveillance over members’ exchange rate policies is the core function of the institution.” But Deputy Governor of the People’s Bank of China Hu Xiaolian said that “in strengthening surveillance, the Fund should be realistic and not overestimate the role of exchange rates. Biased advice would damage the Fund’s role in safeguarding global economic and financial stability.” And the Group of 24 (G-24) developing countries said that it remained doubtful that a revision of the 1977 decision was necessary. It noted in its communiqué following an April 13 meeting that “if the IMF has not been more effective in its surveillance (as the case of persistent global imbalances suggests), it is mainly because systemically important economies have not felt the need to follow the Fund’s policy advice.”

Quotas and voice. The IMFC reiterated the importance of implementing the program of quota and voice reforms adopted by the Board of Governors at the 2006 Annual Meetings in Singapore that was designed to take account of the growing importance of dynamic economies, many of which are emerging market economies, in the global economy, and help enhance the voice and participation of the low-income countries. It welcomed the broad consensus reached in the Executive Board on the legal framework of an amendment of the Articles of Agreement about basic votes. It also welcomed the initial discussions on a new quota formula and stressed the importance of agreeing to a formula that should be “simple and transparent” and capture members’ relative positions in the global economy. The G-24 stressed in its communiqué that “the adoption of a package of reforms aimed at increasing the voice and representation of developing countries remains of utmost importance for the legitimacy and effectiveness of the Bretton Woods institutions.”

IMF income. The IMFC welcomed the report by a committee chaired by Andrew Crockett, Chairman of JPMorgan Chase International, on how to better align the Fund’s income with its diverse activities. It underscored that ensuring a sustainable overall budgetary position “also requires action on the expenditure side. This now includes real spending reductions.” The IMFC said it was looking forward to the Managing Director’s proposals on a new income model.

The main finding of the report was that the current reliance on income from lending was no longer appropriate. Major recommendations for a new income model included broadening the Fund’s investment mandate, investing a portion of quota subscriptions, and establishing an endow-



Sung-Jin Kim, Deputy Minister for International Affairs for Korea (left), and Li Yong, Vice Minister of Finance for China.

Thomas Dooney/IMF Photo

ment from a limited gold sale. In response to questions from reporters on the likelihood of gold sales, given past opposition from major shareholders, Brown said, “What I found encouraging today was that there were countries who previously had not been prepared to consider gold sales and who were prepared to do so now.” He added that “there is no doubt that the gold sales are potentially a part” of the package the Managing Director will put forward.

Emerging market countries. The IMFC welcomed recent progress in clarifying some key aspects of the design of a new liquidity instrument for market access countries. It called on the IMF to “accelerate its work on addressing the design challenges in developing an instrument that would enhance IMF support to these countries’ own strong policies and ensure that substantial and timely financing will be available, if needed, while safeguarding IMF resources and paying due regard to the interaction with existing IMF facilities.” The G-24 similarly urged the IMF to develop a new liquidity instrument “that would provide meaningful, reliable and affordable financial support to face capital account volatility for current and prospective emerging market countries.” But it said that although some progress has been made, a recent proposal heard at the Executive Board fell short of these objectives.

Low-income countries. The IMFC stressed that the Fund should remain fully engaged in helping its low-income

Box 2

Africa welcomes China's greater involvement

African ministers attending the IMF–World Bank meetings welcomed greater involvement by China in Africa’s development, including its stepped-up trade and increased lending to the resource-rich continent. Sub-Saharan Africa’s exports to China rocketed to \$19 billion, or 15 percent of the region’s total exports in 2005, from some \$5 billion in 2000 and a negligible amount in 1990.

Antoinette Sayeh, Liberia’s Minister of Finance, said during a press conference that, in addition to receiving financial help, Africa could learn from China’s rapid development and its enormous progress in poverty reduction. N’Gandu Peter Magande, Zambia’s Minister of Finance and National Planning, noted that his country’s ties with China dated back to the 1960s, when it helped finance the building of a key African rail link. “For us, really, this is an old friend, and we think they’re an all-weather old friend.” Rama Krishna Sithanen, Mauritius’s Deputy Prime Minister and Minister of Finance and Economic Development, said China’s involvement was a good example of increasing cooperation between developing countries to complement the historical pattern of North-South trade.



Liberia’s Minister of Finance, Antoinette Sayeh (left), and Timothy Thahane, Minister of Finance and Development Planning for Lesotho.

member countries achieve sustainable growth and address the macroeconomic challenges critical to the achievement of the UN Millennium Development Goals (MDGs). It called for “continued efforts to help countries reap the benefits of higher aid and debt relief, and avoid a new buildup of unsustainable debt.” At a press conference of African finance ministers on April 13, China drew praise for its growing role in providing financial and technical support (see Box 2).

The IMFC also thanked the External Review Committee on IMF–World Bank Collaboration, which was chaired by Pedro Malan, Chairman of the Board of Unibanco and former Finance Minister of Brazil, noting that it looked forward to proposals from the two institutions to strengthen collaboration.

Still-elusive poverty goals

At the IMF–World Bank Development Committee meeting on April 15, a major theme was the scaling up of aid, especially for Africa—which is not on track to reach the poverty MDG and looks likely to miss most of the other MDGs, according to the latest IMF–World Bank *Global Monitoring Report*. World Bank President Paul Wolfowitz told reporters that “the donors unfortunately now are in danger of not fulfilling their promises to increase aid and to double aid to Africa.” De Rato echoed this sentiment, saying that “fulfilling aid commitments such as those made at Gleneagles in 2005 is a very important prerequisite to create sufficient space for high social and infrastructure investment.” The committee, which was chaired by Mexico’s Secretary of Finance and Public Credit and a former IMF Deputy Managing Director, Agustín Carstens, noted that official development assistance (ODA) flows have grown in real terms over the past decade, but total ODA may have declined in real terms in 2006. ■

Laura Wallace
IMF Survey

IMFC backs Fund reforms at time of strong global growth

Following is the full text of the communiqué issued by the International Monetary and Financial Committee (IMFC) after its meeting in Washington, D.C., on April 14. The meeting was chaired by Gordon Brown, Chancellor of the Exchequer of the United Kingdom.

The global economy and financial market outlook

The Committee welcomes the continued strong, broad-based expansion of the global economy. Growth is becoming regionally more balanced and is expected to remain strong in 2007 and 2008. Global financial stability continues to be underpinned by solid economic foundations. Downside risks requiring continued vigilance arise from the possibility of a reassessment of risks in global financial market conditions, of a sharper-than-expected slowdown in the U.S. economy, and of a revival of inflationary pressures as output gaps close or if oil prices rebound. The risk to the global economy from a possible rise in protectionism and the substantial forgone growth should the Doha Round fail makes trade policy a key medium-term concern. The Committee welcomes progress and continued focus, in IMF surveillance, on the agreed strategy for promoting an orderly unwinding of global imbalances over the medium term. It encourages policies that allow countries to take advantage of financial globalization while containing vulnerabilities.

In the advanced economies, monetary policy needs to remain committed to maintaining price stability while taking account of the situation of different countries. Fiscal positions are strengthening, and now is a good time to further advance fiscal consolidation and the fundamental reforms that will help ensure fiscal sustainability in the long term. The focus should be on measures to ensure the viability of health care and pension systems in the face of population aging. Potential growth will be bolstered by reforms to enhance the capacity of labor to adapt to, and take full advantage of, globalization, complemented in many countries by further steps to enhance productivity and competition in product and services markets and further steps for free trade and market access.

Emerging market and other developing countries continue to perform strongly and are making progress in improving their resilience to possible turbulence in financial markets and volatility in commodity prices. To consolidate this performance and promote sustained growth that is broadly shared, continued efforts are needed to strengthen budgetary positions and improve debt management practices, entrench the credibility of monetary and fiscal policies, and ensure the sustainability of external positions. Advancing reforms to



South Africa's Finance Minister, Trevor Manuel (left), and South African Reserve Bank Governor, Tito Mboweni.

improve the functioning of domestic financial markets and enhance the business and investment environment remains a key medium-term priority. Among some surplus countries, there is a continued need to boost domestic demand and allow for greater exchange rate flexibility.

The Committee is particularly encouraged by the continued robust growth in low-income countries, including in sub-Saharan Africa. It calls on poor countries and donors to continue working in partnership to build on this strong performance so as to accelerate progress toward achieving the Millennium Development Goals (MDGs). Countries should persevere with sound macroeconomic policies and reforms to foster vibrant and diversified market-based economies. The international community should support these countries' efforts with increased and more efficient aid, including through fulfilling the pledges made by donors to double aid to sub-Saharan Africa by 2010. The Committee also stresses the importance of further trade liberalization and delivering Aid for Trade commitments. In this context, it looks forward to the early establishment of the enhanced Integrated Framework.

The Committee welcomes the report it has received from IMF Managing Director [Rodrigo de Rato] and the participants in the multilateral consultation on global imbalances launched following the spring 2006 IMFC meeting. It agrees that resolving imbalances in a manner compatible with sustained global growth is a shared responsibility and notes that the policy plans set out by the participants—China, the euro area, Japan, Saudi Arabia, and the United States—represent further progress in the implementation of the strategy the Committee has previously set forth and endorsed. The Committee also notes the assessment by Fund staff that, as these policies are implemented, they will make a significant contribution to reducing global imbalances. It considers that the experience

gained so far demonstrates that the multilateral consultation approach has been useful for addressing global issues through discussion and cooperation among members and should prove to be a valuable instrument going forward for enhancing and deepening Fund surveillance. It looks forward to the Executive Board's review of the experience with the process and the conclusions of the first multilateral consultation and of the lessons for the future.

The Committee welcomes the resumption of the Doha Round trade negotiations and calls on WTO [World Trade Organization] members to work with a renewed commitment to urgently achieve an ambitious outcome. Benefiting from the report by WTO Director-General Pascal Lamy on the current status of the negotiations, the Committee looks for strong political leadership from those countries now playing a central role in the negotiations to forge the necessary breakthrough. The Committee emphasizes that all members stand to benefit from a Doha Development Round outcome that promotes growth and fosters economic development by reducing trade barriers and strengthening the multilateral trade system. The Committee considers it critically important to ensure that the benefits of globalization are widely shared and help reduce poverty and income disparities.

Implementation of the IMF's Medium-Term Strategy

The Committee welcomes the steps being taken to strengthen and modernize IMF surveillance to ensure its effectiveness as globalization deepens. It calls on the Executive Board to continue to give priority to further work on all aspects of this reform, including updating the 1977 Decision on Surveillance over Exchange Rate Policies. The goal should be to improve the quality of surveillance, its focus, candor, and evenhandedness. In this context, ensuring a medium-term perspective and external stability is important. In this connection, the Committee looks forward to the discussion of the Independent Evaluation Office's (IEO) report on the Evaluation of the IMF's Advice on Exchange Rate Policy. The Committee, with a view to gaining broad support across the membership, agrees that the following principles should guide further work: first, there should be no new obligations, and dialogue and persuasion should remain key pillars of effective surveillance; second, it should pay due regard to country circumstances and emphasize the need for evenhandedness; and third, it should retain flexibility to allow surveillance to continue evolving.

The Committee supports the efforts being made to strengthen the way financial sector, capital market, and exchange rate issues are addressed in surveillance, and to enhance the focus of surveillance on key risks facing members and on cross-country spillovers. It notes the effort of the Fund

in enhancing the methodology for assessing the effectiveness of surveillance. The Committee welcomes the continuing work by the Board on independence and accountability in surveillance, as well as on a remit, which could provide a clear statement of surveillance priorities. The Committee welcomes the priority being given by the Fund to enhancing and deepening the international community's understanding of financial stability issues, which will need to be an increasing focus of the Fund's surveillance. It looks forward to further steps by the Fund to promote dialogue on how financial markets and innovation can work to foster economic growth and financial stability, including possibly in the context of further multilateral consultations. The Committee looks forward to the review of streamlined Article IV consultations.

Recognizing the need for more predictable and stable sources of Fund income, the Committee expresses its gratitude to the Committee of Eminent Persons to Study Sustainable Long-Term Financing of the IMF for its report recommending a package of measures to better align the IMF's income with its diverse activities. The Committee considers that the report provides a sound basis for further work on the development of a new income model aimed at broadening its income base that can garner broad support across the membership. It looks forward to proposals on a new income model by the Managing Director for consideration by the Executive Board. The Committee underscores that ensuring a sustainable overall budgetary position to underpin the implementation of the IMF's Medium-Term Strategy also requires action on the expenditure side. This now includes real spending reductions. The Committee welcomes the Fund's ongoing efforts to improve resource allocation and cost-effectiveness in line with the priorities of the Medium-Term Strategy. The Committee looks forward to a report on progress on expenditure issues.

The Committee reiterates the importance of implementing the program of quota and voice reforms adopted by the



Pascal Lamy, Director-General of the World Trade Organization.

Michael Spiloto/IMF Photo

Board of Governors in Singapore, in line with the timetable set out in the Resolution. It welcomes the broad consensus reached in the Executive Board on the legal framework of an amendment of the Articles of Agreement regarding basic votes. The Committee welcomes the initial informal Board discussions on a new quota formula and stresses the importance of agreeing on a new formula, which should be simple and transparent and should capture members' relative positions in the world economy. This reform would result in higher shares for dynamic economies, many of which are emerging market economies, whose weight and role in the global economy have increased. The Committee also stresses the importance of enhancing the voice and participation of low-income countries, a key mechanism for which is an increase in basic votes, at a minimum preserving the voting share of low-income countries. The Committee calls on the Executive Board to continue its work on the reform package as a matter of priority.

The Committee attaches high importance to further steps by the IMF to strengthen its engagement with emerging market economies. It welcomes the recent progress made in clarifying some key aspects of the design of a new liquidity instrument for market access countries. It calls on the IMF to accelerate its work on addressing the design challenges in developing an instrument that would enhance IMF support for these countries' own strong policies and ensure that substantial and timely financing will be available if needed, while safeguarding IMF resources and paying due regard to the interaction with existing IMF facilities.

The Committee looks forward to progress on steps to assist members to deepen financial sectors, including local capital markets. It also looks forward to a review of the Fund's policy on lending into arrears. The Board should also conclude its review of charges for Fund financial assistance and its maturity structure.

The Committee stresses that the IMF should remain fully engaged with its low-income members in helping them achieve macroeconomic stability supportive of sustainable growth, critical to the achievement of the MDGs. This includes well-designed financial and policy support in the context of surveillance, Fund arrangements, and technical assistance. The Committee calls for continued efforts to help countries reap the benefits of higher aid and debt relief and avoid a new buildup of unsustainable debt. The Committee welcomes the recent enhancements to the debt sustainability framework for low-income countries. It urges all creditors and borrowers to work with the World Bank and the IMF to use the framework as a tool for fostering coherent and responsible lending practices, identifying emerging debt-related vulnerabilities, and elaborating country-owned debt



Agustín Carstens, Chairman of the Development Committee and a former IMF Deputy Managing Director (left), and IMF First Deputy Managing Director John Lipsky.

strategies. The Committee looks forward to further work on the IMF's role in the poverty reduction strategy process and its collaboration with donors.

The Committee expresses its gratitude for the work of the members of the External Review Committee on IMF–World Bank Collaboration. The Committee welcomes the report's message that a culture of close cooperation between the IMF and the World Bank, taking into account each institution's comparative advantages, respective mandate, and responsibilities, is key to delivering services to members more effectively and efficiently. The Committee looks forward to proposals from the two institutions to strengthen collaboration.

Other issues

The Committee calls for closer cooperation between the IMF and the Financial Action Task Force in promoting stronger implementation of international anti-money-laundering and combating terrorist financing standards and encourages publication of comprehensive country evaluations.

The Committee recommends members' acceptance of the Fourth Amendment of the Articles of Agreement for a special onetime allocation of SDRs.

The Committee values highly the contribution of the IEO to the learning culture of the IMF and to facilitating oversight and governance. It welcomes the evaluation of the IMF and Aid to Sub-Saharan Africa and the steps being taken to ensure that the IEO recommendations endorsed by the Executive Board are effectively internalized in the work of the IMF.

The Committee expresses its appreciation of the work of Agustín Carstens as Deputy Managing Director and wishes him success in his new responsibilities as Secretary of Finance and Public Credit of Mexico and Chairman of the Development Committee.

The next meeting of the IMFC will be held in Washington, D.C., on October 20, 2007. ■

Western Hemisphere economic outlook

Latin America enjoys longest sustained growth in 30 years

Latin America is in the middle of its strongest expansion since the 1970s, and the outlook remains favorable for sustained growth. For most countries, the outlook for inflation is favorable too, according to the IMF's regional economic outlook for the Western Hemisphere.

The good performance has resulted from a combination of generally sound economic policies and a benign international economic situation, including high commodity prices, that have enabled many countries to raise spending and still reduce deficits, the report said.

As a result of the strong growth, unemployment rates and poverty rates fell and, for the first time in decades, there was a moderate reduction in regional income inequality. However, inequality remains quite high compared with much of the rest of the world, according to the outlook, prepared twice a year by the IMF's Western Hemisphere Department.

Overall, economic growth was 5.5 percent in the Latin American and Caribbean (LAC) region last year and has averaged 5.25 percent for the past three years (see Chart 1). Growth is expected to slow a bit this year, to just under 5 percent, and to about 4.25 percent next year, a reflection of "a deceleration from historically high rates in a number of countries, the slowdown in the U.S. economy, and some declines in commodity prices." Real GDP growth in the United States is forecast to be 2.25 percent in 2007 compared with 3.3 percent last year. The slower U.S. growth also affects Canada, which is forecast to grow 2.5 percent this year.

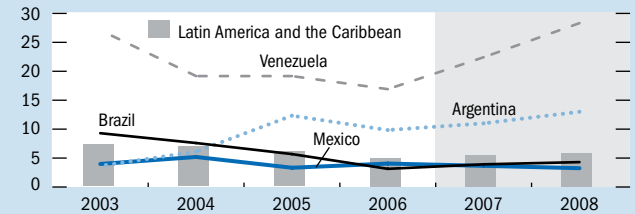
Inflation declined in most LAC countries last year, to a regional average of 5 percent, and is expected to rise only slightly in 2007 (see Chart 2). But the IMF noted that the "decline was not universal." In several countries, "inflation

Chart 2

Positive inflation outlook

For most LAC countries, the rate of inflation has slowed, and price increases will continue to be moderate.

(percent, end of period)



Source: IMF staff estimates.

Note: The shaded area shows projections.

accelerated or remained high as economic activity continued to expand beyond potential."

The strong growth coupled with moderate inflation and expanded social assistance programs in many countries contributed to a continuing improvement in social indicators. Unemployment rates fell, as did poverty rates. The average Latin American poverty rate fell from 44 percent in 2002 to about 40 percent in 2005 and "is estimated to have fallen further to 38 percent in 2006," the report said, citing data from the United Nations Economic Commission for Latin America and the Caribbean. The largest reductions occurred in Venezuela and Argentina. "Falling poverty reflects both strong income growth and a moderate reduction in income inequality," the regional outlook said. It said 13 of the 18 countries for which data are available showed an improvement in income distribution, although inequality "remains very high compared with other regions."

Anoop Singh, Director of the Western Hemisphere Department, told reporters that Latin American economic policies "will need to be vigilant to ensure that the safety margins built up during 2006 do not erode over the next year. With public outlays and imports projected to continue growing at high rates, fiscal and external surpluses are expected to decline." That points to the "need to rein in the growth of government spending, especially for current outlays, which have been rising particularly rapidly in recent years."

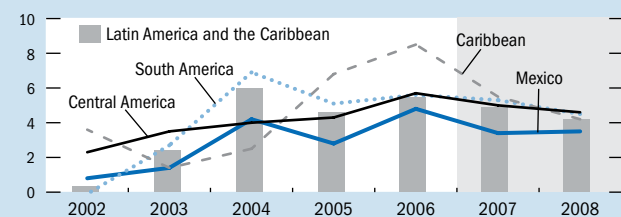
Singh also emphasized the need to continue to increase equity in Latin America and said living standards can best be raised through continued growth, which, although high by Latin American standards, is no more than "average" when compared with other developing regions. ■

Chart 1

Sustained expansion

The Latin American and Caribbean region is experiencing the strongest growth in real GDP it has seen since the 1970s.

(annual percent change)



Source: IMF staff estimates.

Note: The shaded area shows projections.

Sub-Saharan Africa economic outlook

Growth outlook is positive, but more reforms are needed

Growth in sub-Saharan Africa (SSA) remained strong at 5–6 percent for the third consecutive year and is expected to edge up to 6–7 percent in 2007 with a renewed rise in oil production, says the IMF's latest regional economic outlook (REO) (see chart). Even in oil-importing countries, growth should remain steady at about 5 percent. Inflation for the region is projected to remain unchanged at about 7 percent, with single-digit inflation in three-fourths of the countries. The higher growth trend in SSA is attributable to foreign demand, as well as to strong domestic investment and productivity gains supported by sound economic policies in most countries.

Although SSA governments “are spending more to reduce poverty and provide critical government services, financed in part by debt relief,” the REO, prepared by the IMF's African Department, says it is too early to assess whether the higher growth has reduced poverty. At a press conference on April 13, African Department Director Abdoulaye Bio-Tchané said, “While overall growth has been strong, meeting the Millennium Development Goals [MDGs] still seems unlikely. To reduce poverty by 50 percent, the growth rate will need to be at least 1, perhaps 2 percent more, and social and other obstacles to meeting the nonincome MDGs have not been addressed.” Increased aid flows would help in that respect, but the scaling up of aid promised by the major industrial countries at the 2005 Gleneagles summit has not yet materialized.

Managing higher commodity revenues

SSA's commodity producers have, unlike during past commodity booms, saved a portion of their increased revenue and must determine how and how fast to spend it in light of limited absorptive and implementation capacity. The bottom line is that they must use it productively and manage carefully the scaling up of spending because it risks putting substantial upward pressure on prices and the real exchange rate.

The commodity boom, according to the REO, has improved the region's export prospects. “The time may be ripe for SSA to reverse the long-term decline in its share of trade,” Bio-Tchané told reporters. But, although trade with Asia—China in particular—has expanded dramatically, SSA's exports are still dominated by oil and other commodities. Its inability to diversify is due largely to a lack of infrastructure and the high costs of doing business. According to the regional outlook, some progress has been made in developing functioning financial markets, often considered the “missing link” in facilitating private sector activity. Local currency debt markets can increase the efficiency and trans-

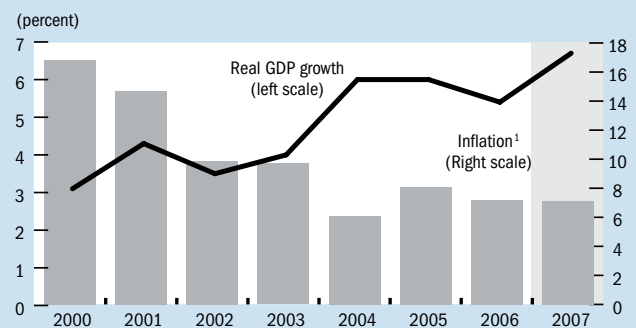
parency of budgetary financing and support the emergence of corporate bond markets, which could help overcome the credit constraints of SSA's private sector.

The REO describes the risks to SSA's outlook as moderate and manageable and notes that policies in most countries support recent stabilization gains. A faster-than-anticipated slowdown in the global economy could alter the region's favorable outlook. Growth and inflation could also be adversely affected by further increases in oil prices and a larger-than-expected fall in nonfuel commodity prices. Some countries could also be affected by a shift in investor sentiment that reverses portfolio investment flows. Finally, the Darfur crisis in Sudan, the conflict engulfing Ethiopia and Somalia, the political problems of Côte d'Ivoire and Guinea, and the fallout from the Democratic Republic of the Congo's recent elections all pose risks to the region, the report says. SSA countries should maintain a sufficient level of reserves and ensure that economic policies are flexible enough to respond to exogenous shocks.

To realize its growth potential, SSA must implement additional reforms. For example, to effectively absorb increased resources from aid and higher oil revenue, countries need to do a good job of coordinating fiscal and monetary policies. They should also institute reforms that bolster absorptive capacity, increase the domestic supply response to higher spending, and enhance productivity. These include liberalizing trade, reducing the costs of doing business, and making labor markets more flexible. ■

A mostly favorable picture

Growth in sub-Saharan Africa is strong and inflation is under control, but the jury is still out on poverty.



Source: IMF, African Department database.

¹ Excluding Zimbabwe.

Note: Shaded area shows projections.

Asian economic outlook

Asian growth to remain strong at more than 7 percent

Asia's overall growth is expected to remain strong in 2007, moderating slightly to just over 7 percent, according to the IMF's latest regional outlook. China and India will continue to lead the way, with growth rates of 10.0 percent and 8.4 percent, respectively. Japan, the largest economy in the region, is likely to see growth broadly unchanged at 2.3 percent as the recovery firms up. David Burton, head of the IMF's Asia and Pacific Department, told a press briefing on April 13 that the forecast reflected a modest easing of external demand, particularly in the United States, and also assumed an effective tightening of policies in China and India.

With an expected moderation in export growth, the regional current account surplus is forecast to stabilize at about 4¼ percent of GDP. "A further rebalancing of growth away from exports and toward a greater reliance on domestic demand will be important over the medium term to put growth on a more sustainable footing," Burton said.

Inflation pressures largely contained

Inflation pressures are contained throughout much of Asia, albeit less so in India and Vietnam, according to the report. In a few countries, high credit growth and, in some cases, asset price rises are causes for concern, and the authorities will need to remain vigilant and ready to further tighten monetary conditions as needed.

"Asian financial markets demonstrated their resilience in the bouts of global market turbulence seen in mid-2006 and again in February–March of this year, generally faring better than emerging markets in other regions. Looking ahead, Asia's good economic prospects point to continued strong investor interest in the region," Burton said.

On balance, the risks to this positive forecast are on the downside, reflecting the possibility of slower-than-expected growth in the United States, an upward spike in oil prices, and a return of financial market turbulence. An upside risk to growth stems from India and China to the extent that measures to cool those economies fail to gain traction.

Although economic prospects for the region remain strong, policymakers nevertheless face a range of challenges, including issues relating to the integration and deepening of Asia's financial system and developments in the global terms of trade.

Net capital flows to the region remain close to their long-term average of about 2 percent of GDP, but gross inflows and outflows have increased sharply in recent

years. And, while Asian currencies have seen upward pressure and reserves have continued to accumulate in the region, current account surpluses rather than capital inflows have been the major cause. The increased volatility of capital flows points to the need to enhance the development and resilience of financial systems. A further gradual liberalization of capital accounts should go hand in hand with this process.

The report noted that housing prices have risen somewhat faster than inflation in recent years, and there are pockets of rapidly rising prices in Asia. That said, housing affordability has not deteriorated markedly outside of Australia and New Zealand, because incomes have kept pace with housing prices. Although judgments in this area are difficult, there is no clear evidence that housing prices are significantly out of line for the region as a whole.

Finally, the report looked at the effects of commodity price booms on a number of Asia's lower-income countries. The challenge for policymakers is to respond to this positive "shock" by formulating a forward-looking strategy to manage—and spend—the resource-related revenues in a way that ensures intergenerational equity and long-term development. ■

Strong regional growth

China and India are the Asian region's growth leaders.

	2005	2006	Latest proj. 2007	Latest proj. 2008
	(year-on-year percent change)			
Industrial Asia	2.0	2.3	2.4	2.1
Japan	1.9	2.2	2.3	1.9
Australia	3.0	2.4	2.6	3.3
New Zealand	2.0	1.5	2.5	2.6
Emerging Asia	8.6	9.0	8.5	8.1
Hong Kong SAR	7.5	6.8	5.5	5.0
Korea	4.2	5.0	4.4	4.4
Singapore	6.6	7.9	5.5	5.7
Taiwan Province of China	4.0	4.6	4.2	4.3
China	10.4	10.7	10.0	9.5
India	8.7	9.1	8.4	7.8
Indonesia	5.7	5.5	6.0	6.3
Malaysia	5.2	5.9	5.5	5.8
Philippines	5.0	5.4	5.8	5.8
Thailand	4.5	5.0	4.5	4.8
Vietnam	8.4	8.2	8.0	7.8
Newly industrialized economies	4.7	5.3	4.6	4.6
ASEAN-5¹	5.5	5.7	5.8	6.0
Asia	7.2	7.6	7.2	6.9

Sources: IMF databases; and IMF staff estimates.

¹Indonesia, Malaysia, Philippines, Singapore, and Thailand.

European economic outlook

Europe set for sustained expansion, says IMF

Europe's upswing is showing momentum, creating bright prospects for 2007 and 2008, according to Michael Deppler, head of the IMF's European Department. "The situation in Europe, which improved markedly last year, is set for a sustained expansion," he told journalists at an April 14 press briefing during the IMF–World Bank Spring Meetings. Europe as a whole is expected to see growth of 3.4 percent in 2007, against 3.7 percent last year (see table). The euro area is set to expand by at least 2.3 percent this year.

Deppler noted that "part of this strong outlook is due to good policies. Monetary policy has been appropriately conducted, fiscal policies have gotten back on track, and countries have undertaken significant structural reforms." In Europe's advanced economies, continuing job creation, falling unemployment, and low inflation are providing the basis for stronger private consumption. In emerging—or perhaps more aptly named converging—Europe, business investment has been boosting production and export capacity, leading to strong growth. More broadly, growth has also benefited from the synergies between east and west, rooted in the general cyclical upswing as well as in more structural developments, such as enlargement.

Europe may well surprise on the upside

While external risks to Europe's economic outlook are tilted to the downside, mainly because of the uncertainty surrounding the U.S. economy, Deppler thought that "it would take a very large negative external shock to significantly derail recovery in Europe." In fact, short-term indicators inspire confidence that the cyclical upswing may exceed expectations.

But there are still risks. A stronger-than-expected slowdown in the United States or a disorderly unwinding of global imbalances

is possible, but the impact on Europe would likely be muted relative to the experience in 2001–02, when the bursting of the dot-com bubble dealt a shock both inside and outside Europe. Most important, the very large cross-border financial flows into central and eastern Europe could push convergence past its speed limits. While these flows have been used productively in most of converging Europe, financial convergence may be running ahead of fundamentals in some countries. Rapid credit growth could sow the seeds for trouble in the event of a generalized retrenchment from risky assets or a domestic policy slippage.

Productivity remains key

According to Deppler, "performance is improving, but we don't know how much is cyclical and how much is structural." Europe's advanced economies are still failing to make notable inroads in closing the transatlantic divide in per capita GDP. Encouragingly, recent labor and product market reforms have helped reduce structural unemployment. But labor utilization remains low and signs of a much-needed revival in productivity growth are tentative.

The best way to achieve higher productivity and improve Europe's potential growth rate is through strengthened competition. To that end, policymakers should seek to further deregulate product markets, complete the EU single market, especially through a swift implementation of the EU services directive, and foster financial integration.

For their part, Europe's converging economies need to deliver the higher growth potential that investors are anticipating. They have made great strides compared with old EU member states, Deppler noted, but viewed over a decade, they are not doing as well as better-performing peers, notably in Asia. For these economies, sustaining the pace of structural reforms is essential. The new member states also need to put in place the policies that will allow them to successfully adopt the euro.

Making good times last

These are well-deserved good times for Europe, Deppler said. However, good times have in the past led to shortsightedness and policy mistakes. To keep up the positive momentum, it will be essential for countries to maintain a medium-term focus in their policies and not let today's positive economic news sidetrack them from addressing the enduring challenges they face—aging, rigidities, and inefficiencies. For both western and eastern Europe, it is very important to take advantage of the current favorable conditions to continue fiscal adjustment and complement continued labor market reforms with a much greater push to improve productivity. ■

Good times ahead

The IMF predicts continued healthy growth in Europe for the next two years.

	2006	Proj. 2007	Proj. 2008
Output growth (annual rate in percent, weighted average)			
Europe ¹	3.7	3.4	3.2
European Union (EU) ²	3.2	2.8	2.7
Euro area ³	2.6	2.3	2.3
Non-euro area advanced economies ⁴	3.0	2.9	2.7
CEEC and Baltics ⁵	6.3	5.7	5.0

Source: IMF staff estimates and projections.

¹Includes all 27 members of the EU, as well as Albania, Belarus, Bosnia and Herzegovina, Croatia, Iceland, Israel, Macedonia, Moldova, Norway, Russia, Serbia, Switzerland, Turkey, and Ukraine.

²Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and United Kingdom.

³Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Slovenia, and Spain.

⁴Cyprus, Denmark, Malta, Sweden, and United Kingdom.

⁵Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, and Slovakia.

Lebanon navigates difficult waters

In early 2006, the Lebanese government outlined an ambitious reform program to reduce the country's large debt and financial vulnerabilities. The timing was opportune because the economy looked poised for a strong recovery. However, the July 2006 conflict with Israel dashed hopes of high growth and forced the government to adapt its reform strategy to the postconflict environment. Donors endorsed the government's revised agenda, presented at the Paris III conference on January 25, 2007, and on April 9, the IMF Executive Board approved a \$77 million loan to Lebanon in the form of Emergency Post-Conflict Assistance, as part of a concerted international effort to assist the country.

The five-week conflict with Israel and the month-long blockade that followed inflicted a heavy human and economic toll on Lebanon. Housing and infrastructure suffered significant damage, many professionals left the country, and economic activity came to a near standstill, with tourism being particularly hard hit. As a result, real GDP in 2006 is estimated to have been flat. Financial markets weathered the crisis surprisingly well, owing to the central bank's skillful management of pressures, the banking system's strong liquidity position, and the timely deposit with the central bank of \$1 billion by Saudi Arabia and \$500 million by Kuwait. Cumulative deposit outflows of \$3 billion during the conflict were recouped by year-end, but deposit dollarization and Eurobond spreads have remained larger than before the conflict.

The conflict has exacerbated Lebanon's challenges in reducing its debt and financial vulnerabilities. The overall fiscal deficit widened in 2006, partly because of conflict-related revenue shortfalls and the need to accommodate relief and reconstruction spending. Donors committed \$1.7 billion to help deal with the fiscal impact of the conflict, but government debt still increased to \$40 billion (179 percent of GDP) by end-2006.

Reform strategy

Against this background, the Lebanese government is seeking to reduce its debt-to-GDP ratio by about 50 percentage points over five years. The reform program envisages fiscal adjustment to begin in 2008 with increases in gasoline excise taxes, the value-added tax rate, and the tax on interest income. In addition, the government plans to introduce a global income tax that will distribute the adjustment effort more evenly. On the expenditure side, the government intends to contain the wage bill and reform the social and energy sectors to limit open-ended transfers from the budget while protecting capi-



French Foreign Minister Philippe Douste-Blazy (left) and Finance Minister Thierry Breton at a press briefing closing a January conference to raise funds for Lebanon.

tal and social expenditures. Privatization of the telecom sector should also help reduce the debt.

The international community endorsed the government's medium-term reform program at the Paris III conference in January. It pledged \$7.6 billion in grants and loans to be disbursed during 2007–10. Of these pledges, \$5 billion will go to the government in the form of budget support and project financing, and the remainder will support private sector development. Donors have indicated that their financial assistance will be conditional on steady implementation of reforms.

It is clear that 2007 will be a difficult transition year. Political tensions constrain the room for maneuver, paralyze legislative action, and adversely affect economic activity and financial markets. Still, the government has, under the IMF's Emergency Post-Conflict Assistance, committed to containing the fiscal deficit, in part by setting a floor on gasoline excise taxes, while allowing for relief and reconstruction spending.

The financing strategy relies on the timely disbursement of donor assistance, which is also important to limit a further buildup of government debt. In addition, the government will undertake important structural reforms in 2007 to support the medium-term reform and debt reduction objectives. These include strengthening public financial management to better align spending with policy priorities and initiating reforms in the social security system and the energy sector. ■

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United Kingdom reaps rewards of globalization

The United Kingdom's macroeconomic performance over the past decade has been enviable. Not only has it secured the highest per capita GDP growth among the Group of Seven major industrial countries (see Chart 1), but it has done so with the lowest volatility while maintaining low and stable unemployment and inflation.

In many respects, the recent U.K. experience is an example of preparation meeting opportunity. The economy has managed to harvest the fruits of two decades of sustained labor and product market reforms to reap the rewards of globalization in recent years (see table). Anchored by sound monetary and fiscal policy frameworks, the United Kingdom has also been able to respond to shocks in a flexible manner. But globalization is an ongoing process, and its future currents are hard to predict. This presents clear challenges for the country because, given its openness and integration with the world economy, global shocks can have immediate and sizable effects. Against this backdrop, macroeconomic and financial policies will need to be ready to help cushion the economy from future shocks.

Conditions are in place for continued robust growth and stability. Following a mild slowdown in 2005, growth has rebounded in the past year, driven largely by domestic demand. Consumption has rallied on the back of solid employment and wage increases, alongside rising housing wealth, while investment has responded to high net rates of return. Economic slack has diminished accordingly. At the same time, energy price increases have boosted inflation, which in turn has pushed up survey measures of inflation expectations to their highest level in years. In light of these developments, the Bank of England



Following a boom in the U.K. property market, the likely overvaluation of house prices increases the risk of an abrupt downward adjustment.

tightened monetary policy starting in mid-2006, raising the policy interest rate to a broadly neutral 5¼ percent by early 2007. Absent any major shocks, the outlook for 2007–08 is good: growth should fall back in line with potential, reflecting recent monetary tightening, and inflation should return to target by end-2007 as the impact of past energy price increases fades. If second-round effects of last year's energy price increases were to push up pay deals, further increases in the policy interest rate could be needed. And, although the current account deficit will widen further in 2007, it should remain steady after that.

Positioning to face risks

Despite these favorable fundamentals, there are risks. Some of them are on the upside, most notably from the possibility that immigration enhances productive capacity more than currently envisaged. On the downside, external risks dominate, especially in light of recent turbulence in global financial markets. A reversal of uncharacteristically low risk premiums, a rise in global interest rates, or an abrupt realignment of major currencies would increase credit and market risks in the U.K. financial system. On the domestic front, the likely overvaluation of house prices increases the risk of an abrupt downward adjustment. And the fallout would be greater if domestic and external risks crystallized at the same time. Positioning macroeconomic policies to be responsive to these types of developments will be critical to ensuring continued strong performance.

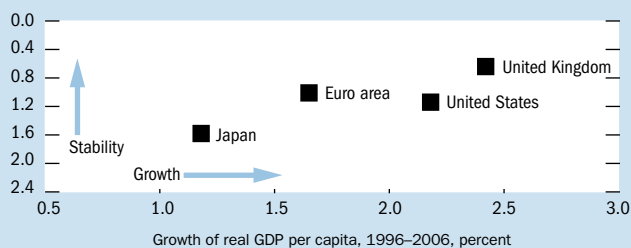
Monetary policy would be on the front line in the event of a shock to aggregate demand. The Bank of England should stand ready to lower the policy rate if the outlook deteriorates,

Chart 1

Outperforming the G-7

The United Kingdom's growth in national income per head during the past decade has been the highest among the major industrial countries.

(variation of annual growth rate from 1996-2006 average, inverted scale, percent)



Source: IMF, World Economic Outlook database.

because of either a sharper-than-expected global growth slowdown or an abrupt adjustment in house prices. More generally, globalization will continue to complicate the conduct of monetary policy in the coming years. For a start, increased immigration—including from new European Union member states—makes it more difficult to assess slack in the labor market. Uncertainty about future immigration further complicates this task. Second, it is possible that the deflationary impact of the Asian productivity boom will wane, either because the underlying boom itself peters out or because people come to anticipate wealth gains from falling prices. The same holds true for the deflationary effect of efficiency gains in the distribution sector. Third, some combination of globalization (specifically, more cross-border labor mobility, which dampens the link between wage setting and domestic labor market conditions) and more credible monetary policy appears to have weakened the relationship between domestic economic slack and inflation. The implications of these developments for monetary policy are not straightforward. While the Bank of England can worry less about short-term fluctuations in economic slack, it must also heed the increasing persistence of deviations of inflation from target, which would necessitate maintaining a tight stance for a longer period of time.

Creating a cushion

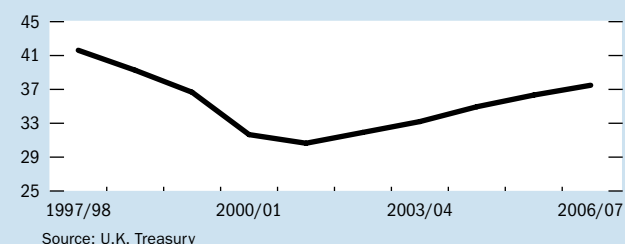
Given the downside risks to the outlook, fiscal policy should also play its role in securing macroeconomic stability, especially by building a cushion that would allow policymakers to respond to adverse shocks. After a few expansionary years, fiscal policy is now on a consolidation path; the deficit is expected to fall back to about 1½ percent of GDP by 2011/12. But such an adjustment will undoubtedly prove challenging, particularly because the government plans to rely mainly on reining in current expenditure growth. In this vein, the upcoming Comprehensive Spending Review will be crucial. Beyond the five-year horizon, it will be essential to keep the deficit at about 1½ percent of GDP to gradually reduce debt sufficiently below 40 percent of GDP to permit

Chart 2

Beneath the ceiling

The fiscal deficit needs to be cut to keep public debt below 40 percent of GDP.

(net public debt, percent of GDP)



the government to maintain this as a ceiling at all times (see Chart 2). As these adjustments occur, the fiscal framework, undergirded by the two fiscal rules—the golden rule, requiring current balance over the cycle, and the debt ceiling—will guide the process and be a useful brake on discretion. To enhance the transparency of the government’s fiscal projections, the independent National Audit Office could be granted greater responsibility to audit a broader array of fiscal assumptions.

The financial sector will also play a crucial role in safeguarding stability, especially given the nature of the dominant risks and the United Kingdom’s position in the global financial system. Although the U.K. banking system is among the strongest in the world, certain vulnerabilities could come to the fore if some of the global risks were to materialize. Mounting leverage, especially among commercial property companies and parties to leveraged buyouts, is one source of vulnerability, and household debt trending upward is another. The linkages between the United Kingdom and other financial systems, while fostering risk transfer, mean that adverse shocks could hit widely and rapidly. These issues are at the heart of the authorities’ continuing efforts to improve the resilience of the financial system to shocks. Plans to enhance stress testing and international crisis prevention and management arrangements are especially welcome.

In conclusion, to sustain success in the United Kingdom, macroeconomic and financial policies must remain attuned to the changing global environment. Monetary policy will need to walk a tightrope amid competing risks, including those that emanate from globalization trends. Fiscal policy should be geared toward building a cushion to cope with possible shocks. And financial sector policies need to keep a close eye on vulnerabilities. ■

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Enviably performance

The U.K. economy is anchored by sound monetary and fiscal policy frameworks.

	2004	2005	2006	Proj. 2007	Proj. 2008
Real GDP (percent change)	3.3	1.9	2.7	2.9	2.7
Unemployment rate (percent of labor force)	4.8	4.8	5.4	5.3	5.1
General government balance (fiscal year, percent of GDP)	-3.2	-2.8	-2.5	-2.1	-1.8
Consumer price index (percent change)	1.3	2.1	2.3	2.3	2.0
Current account balance (percent of GDP)	-1.6	-2.4	-2.9	-3.1	-3.2

Sources: U.K. Office for National Statistics; and IMF staff projections.

The China “growth miracle” examined

China’s phenomenal economic growth over the past three decades had been underpinned by its strong export performance. But what is driving this tremendous growth in trade, and what are the implications for the global economy? These were some of the questions explored at a research conference organized by the IMF on April 6 on the global implications of China’s trade, investment, and growth.

Dissecting China’s exports

China experts from the IMF, the U.S. Federal Reserve system, and academia presented a series of papers probing the nature of China’s exports and their relation to imports. Contrary to the belief that China’s export growth is from new, high-skill products, Mary Amiti (New York Federal Reserve) and Caroline Freund (IMF) found that only 5–15 percent of China’s export growth is in new products and that the skill content of China’s exports (excluding processing trade) has not increased. Li Cui and Murtaza Syed (both IMF) argued that the role of processing trade is declining in China, and the export sector relies more on domestic industries as suppliers for parts and components.

In contrast, Judith Dean, Zhi Wang (both U.S. International Trade Commission), and K.C. Fung (University of California, Santa Cruz) developed a methodology to measure the import content of China’s exports and found it has been rising over time, especially for more sophisticated products. Foreign investment has helped the export boom, according to Deborah Swenson (University of California, Davis), who found that the presence of foreign firms indeed promotes Chinese firms’ exports.

Impact on rich and developing countries

China’s boom is affecting rich countries and developing neighbors alike. Peter Schott (Yale University) found that although China’s exports overlap with those from advanced economies

more than would be predicted from its size and level of development, its products are priced lower and price differentials have widened. This suggests that advanced economies may be adapting to competition from China by moving up the quality ladder. Alternatively, China’s productivity may be high and rising, implying that China’s exports will displace goods made in advanced economies.

Shaghil Ahmed and his coauthors at the Federal Reserve Board looked at the increasingly important role that China plays in East Asia. They found that, as an assembler of finished goods, China is primarily a conduit for growth, but its size and rapid development mean that it has the potential to become an important growth engine.



Chinese workers make shoes at a factory in Wenzhou in China’s Zhejiang province.

Xinhua/Gamma Presse

Looking ahead

In the future, IMF First Deputy Managing Director John Lipsky said, China would have to look inward to sustain

growth by boosting internal demand, improving the financial system, ensuring more even growth between rural and urban areas, and addressing environmental concerns.

David Dollar (World Bank) and Shang-Jin Wei (IMF) said that improved allocation of investment will provide China with ample funds to increase consumption while maintaining growth. From the results of a survey of firms in 120 Chinese cities, they found that state-owned firms are still far less efficient than private or foreign firms even after two decades of reform. This implies that China could achieve the same growth rate with much less investment (and hence more consumption) if its allocation of capital were more efficient. ■

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These papers and a conference program can be found at <http://www.imf.org/external/np/seminars/eng/2007/china/index.htm>



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