The Role of the IMF in the Global Financial Crisis

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I. Economic and financial developments

Global economy faces its most severe recession since WWII

Global outlook deteriorated sharply since October 08; modest turnaround expected with policy stimulus

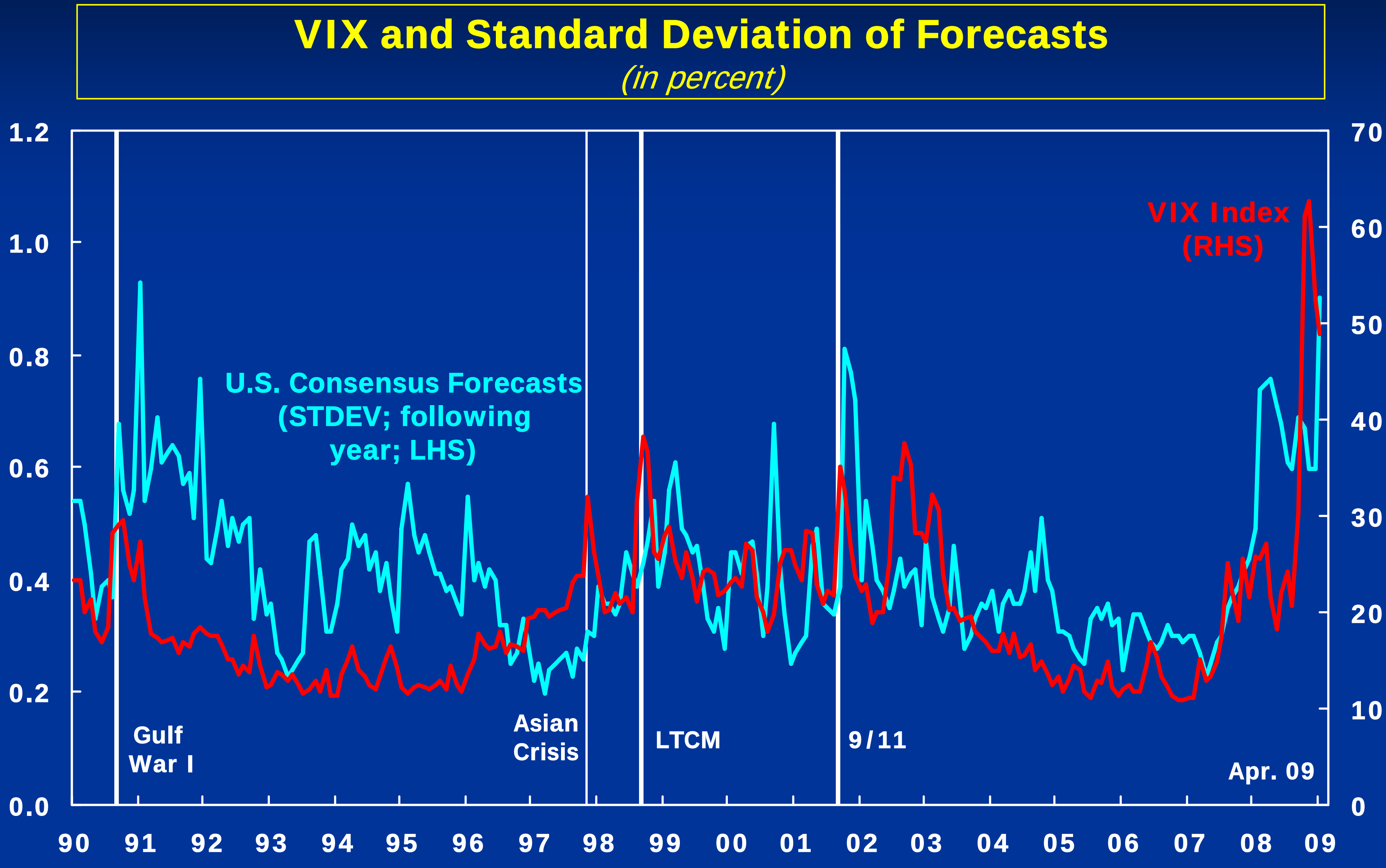
WEO Real GDP Growth Projections

(In percent change from a year earlier)

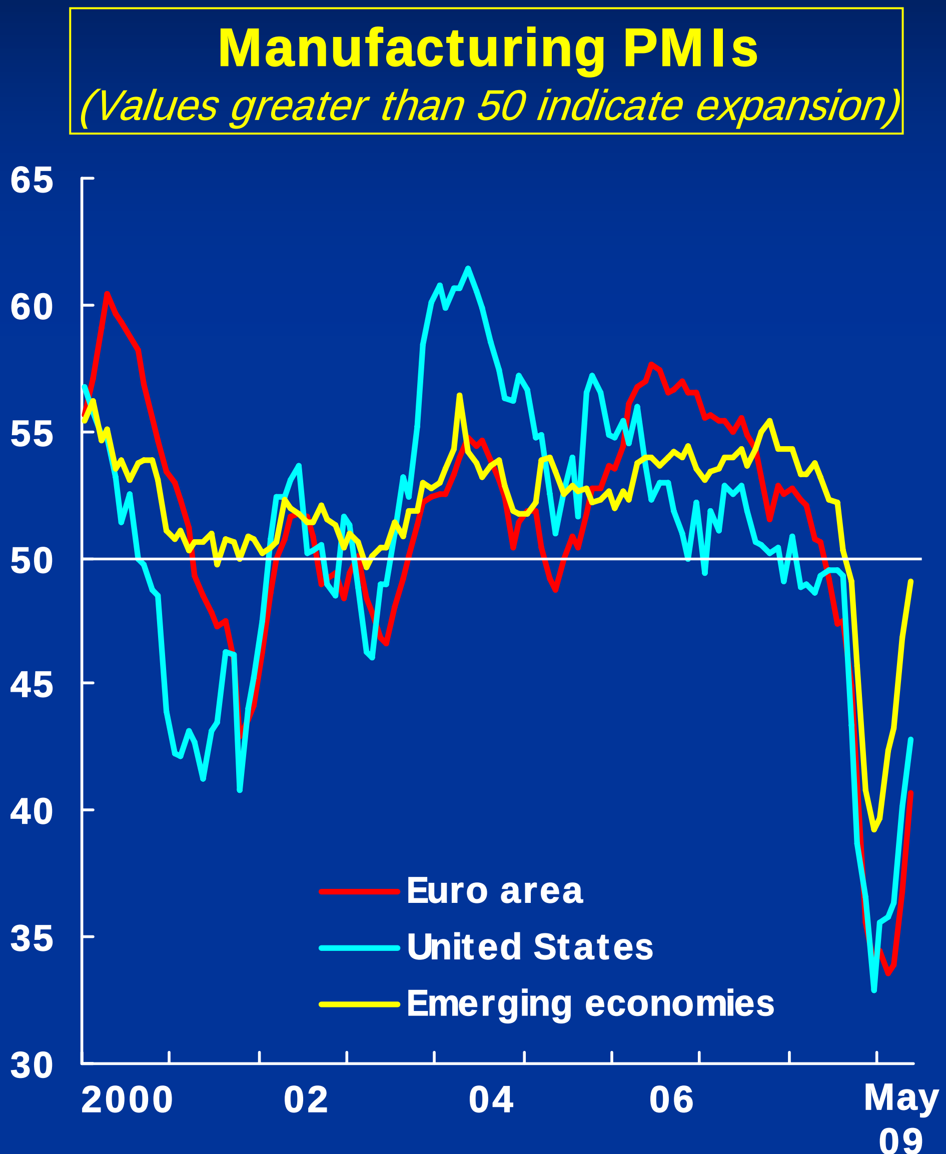
	U.S.	Euro	Japan	China	India	World
2009 (Apr. 09)	-2.8	-4.2	-6.2	6.5	4.5	-1.3
2009 (Oct. 08)	-0.7	-0.5	-0.2	8.5	6.3	2.2
Change	-2.1	-1.5	-6.0	-2.0	-1.8	-3.5
2010 (Apr. 09)	0.0	-0.4	0.5	7.5	5.6	1.9
2010 (Oct. 08)	1.5	0.9	1.1	9.5	6.8	3.8
Change	-1.5	-1.5	-0.6	-2.0	-1.2	-1.9

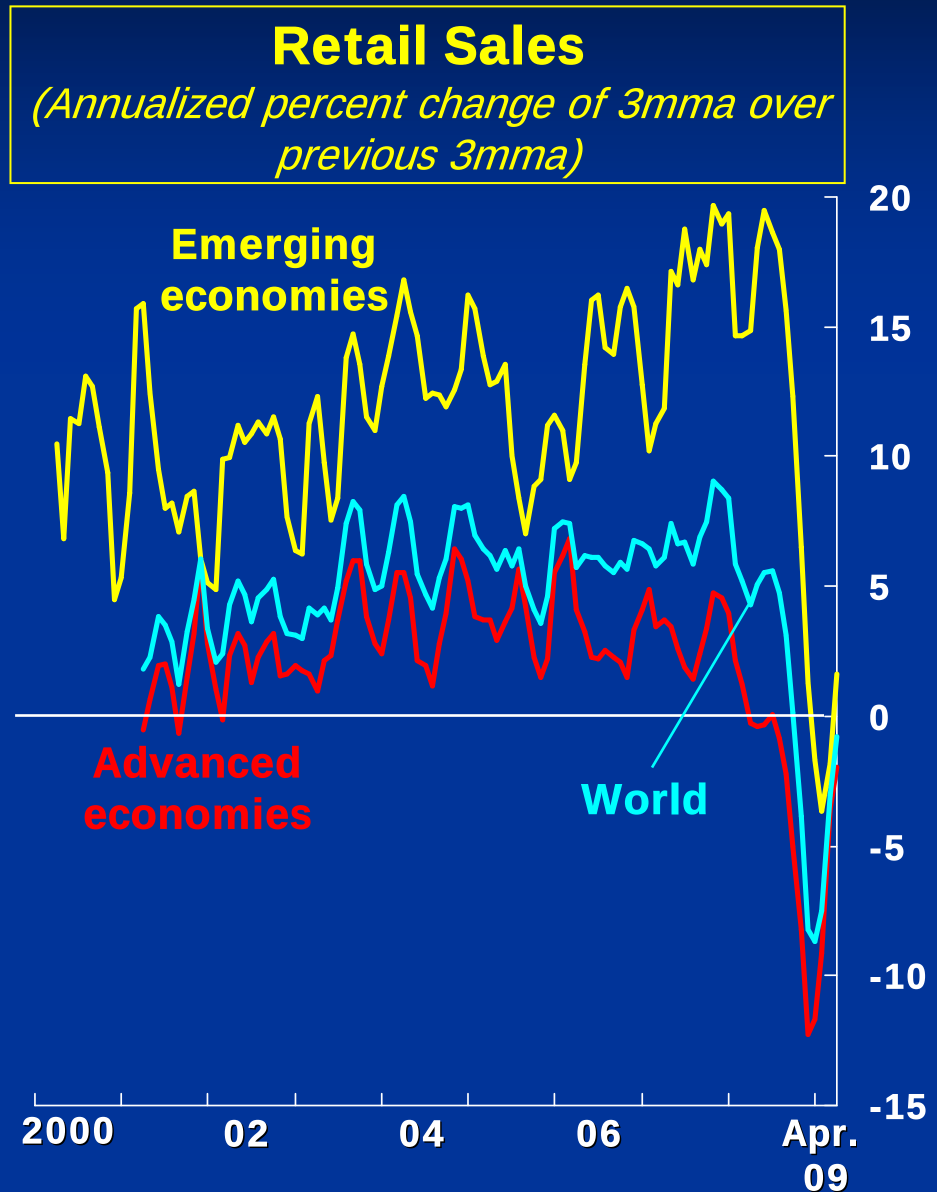
Source: IMF, World Economic Outlook, April 2009 Update.

Heightened uncertainty a defining feature of the crisis

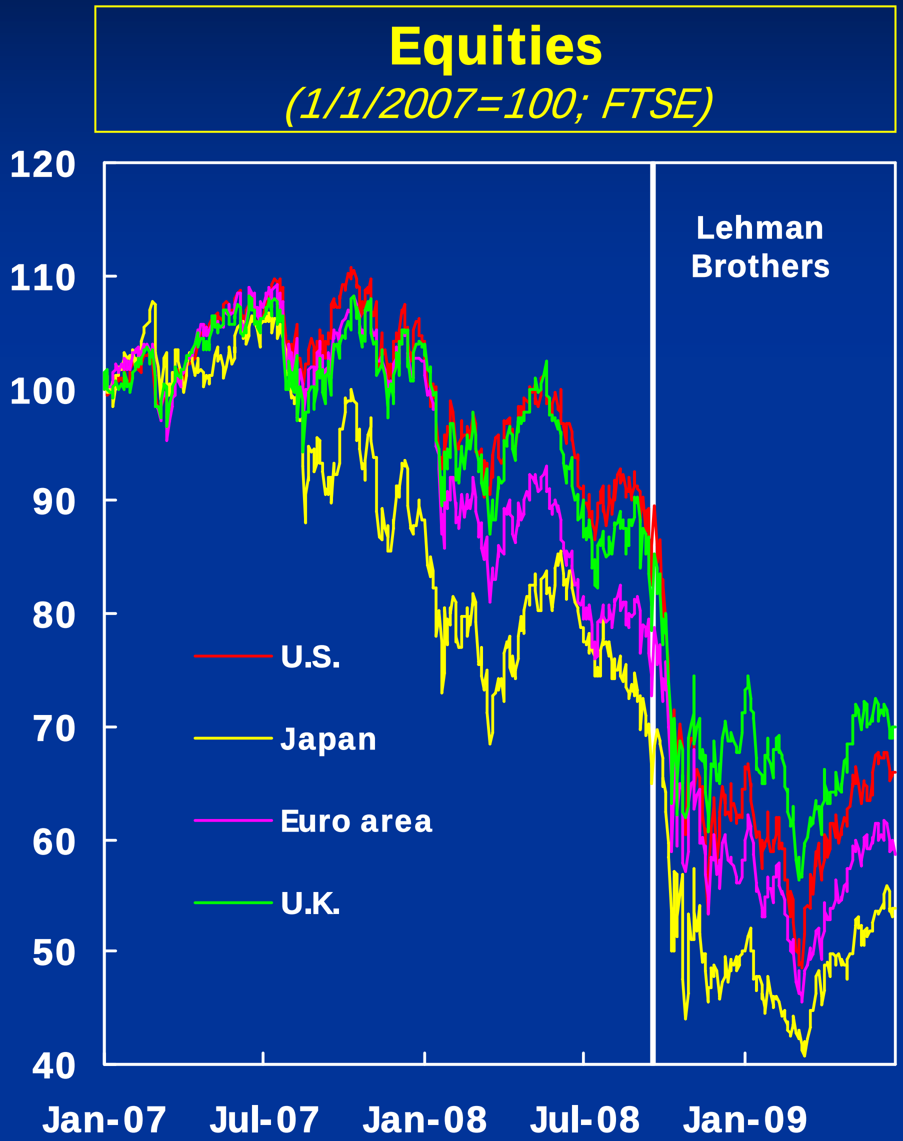


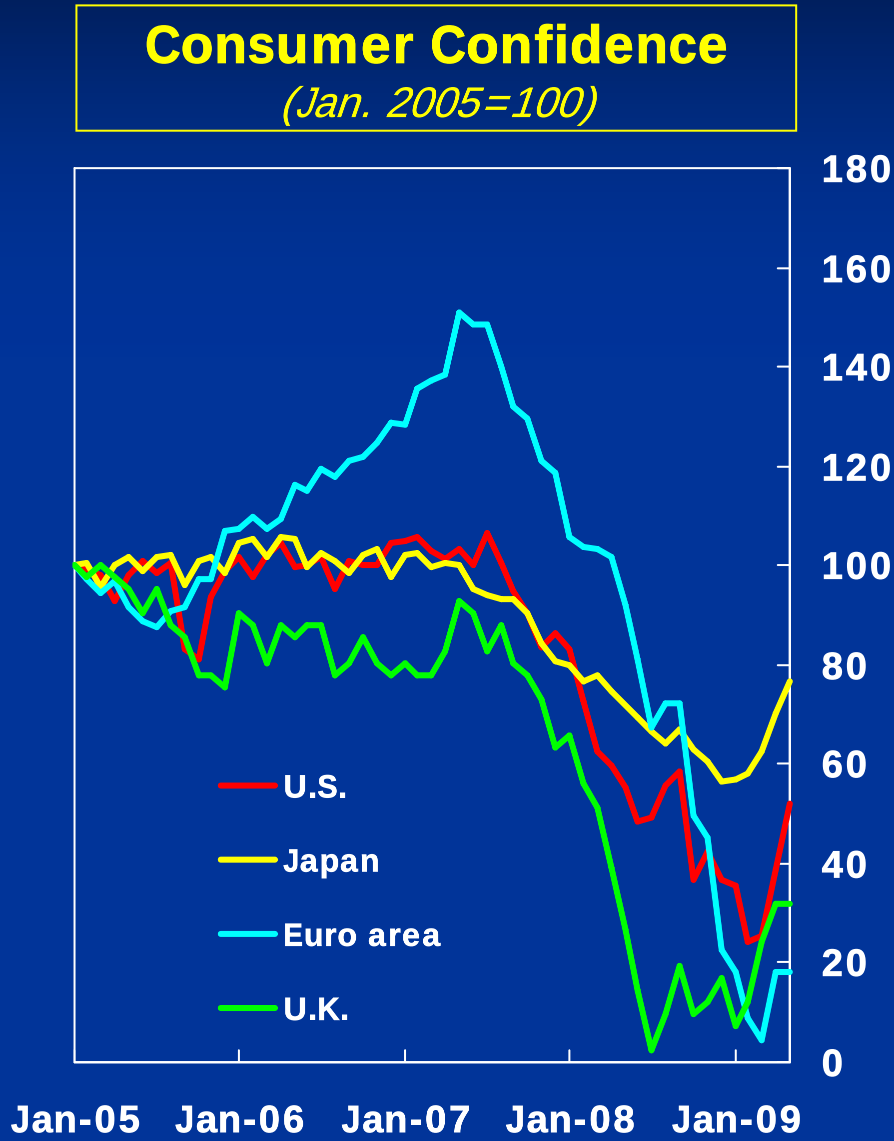
Tentative signs of stabilization emerged in April-May 2009…





...as equity markets and consumer confidence recovered





Causes of output collapse – Advanced countries

- Negative feedback loop between financial sector and real economy
- Deleveraging → Market correction → Lower wealth, collapsing confidence, falling demand
- Recession → NPLs → provisioning, bank losses

Causes of output collapse – emerging markets

- Declining external demand and exports
- External financing constraints
- Lower commodity prices

Recovery prospects and risks

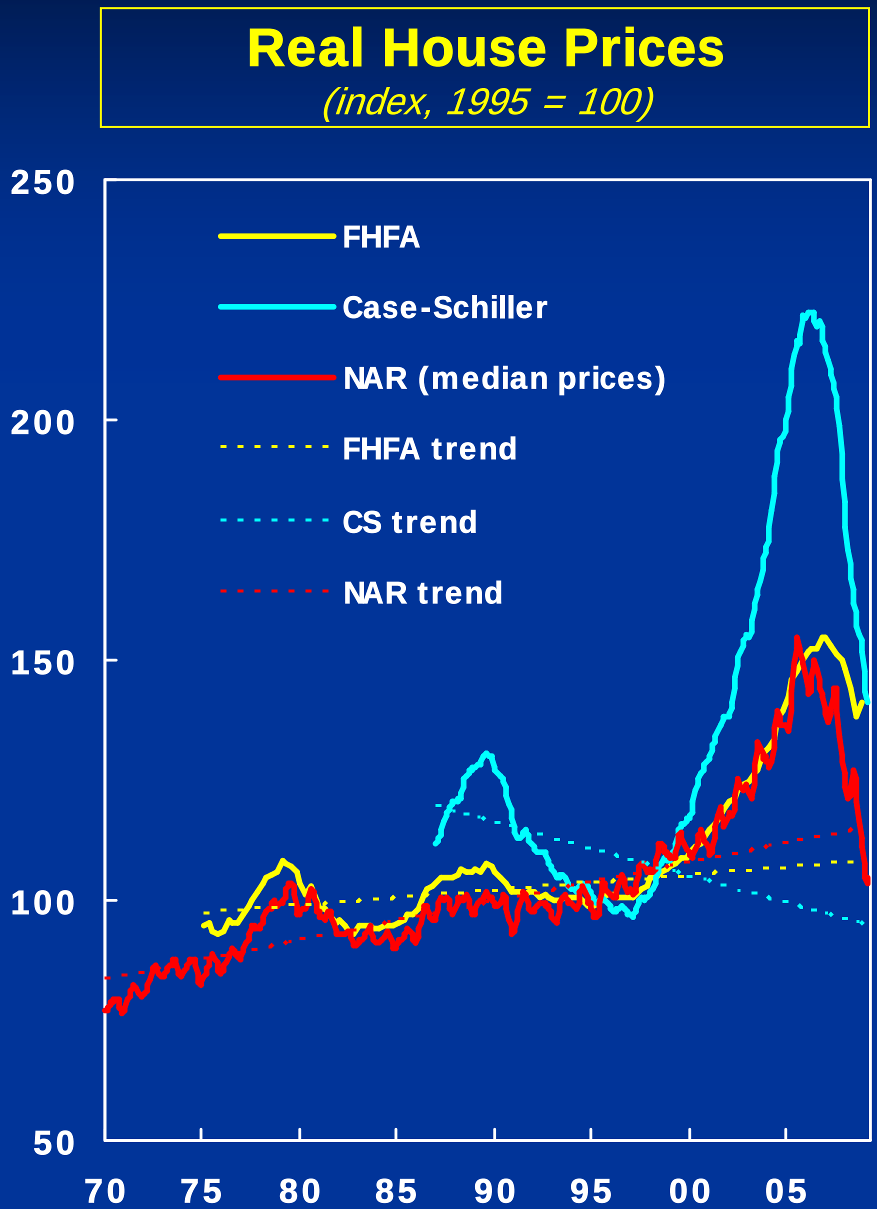
Recovery prospects based on:

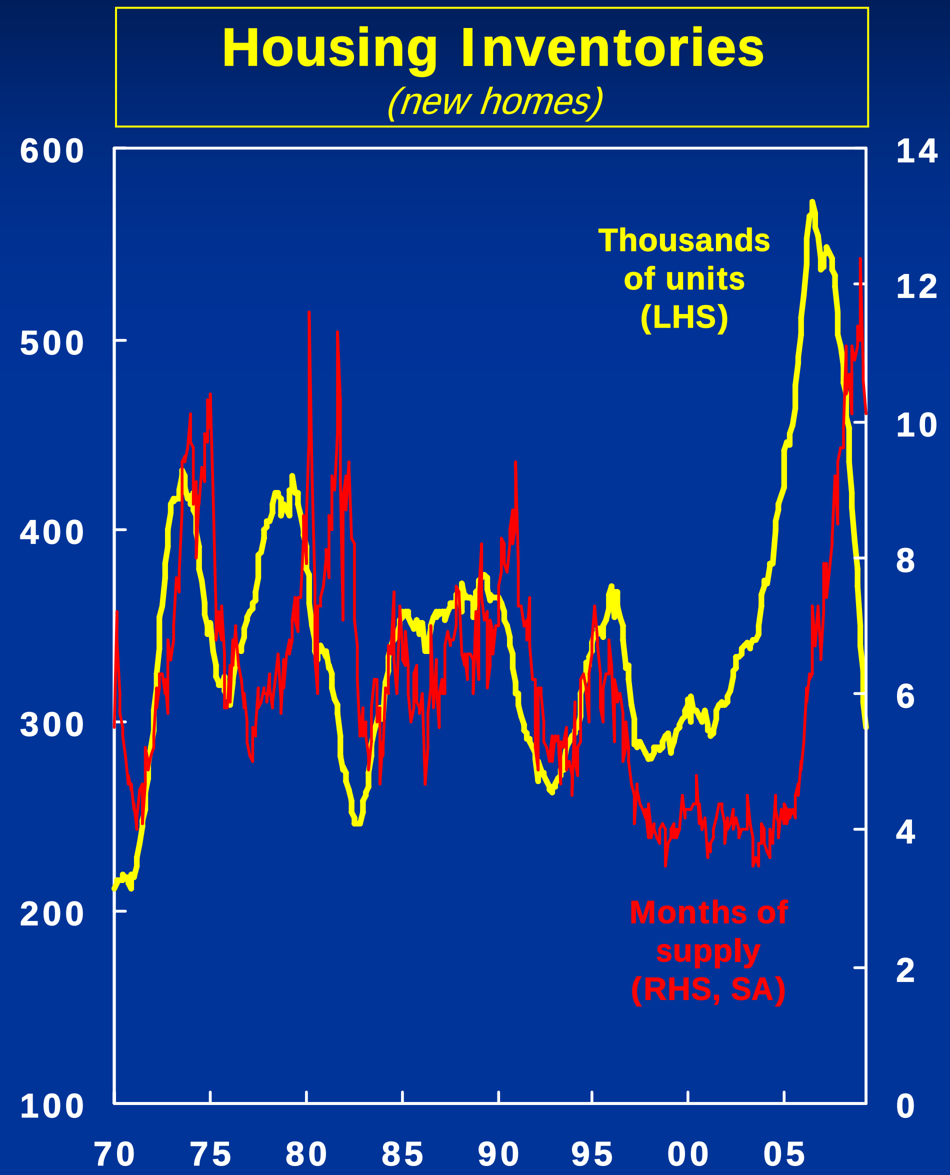
- Slow improvement of financial system
- Housing price stabilization
- Fiscal stimulus

Risks:

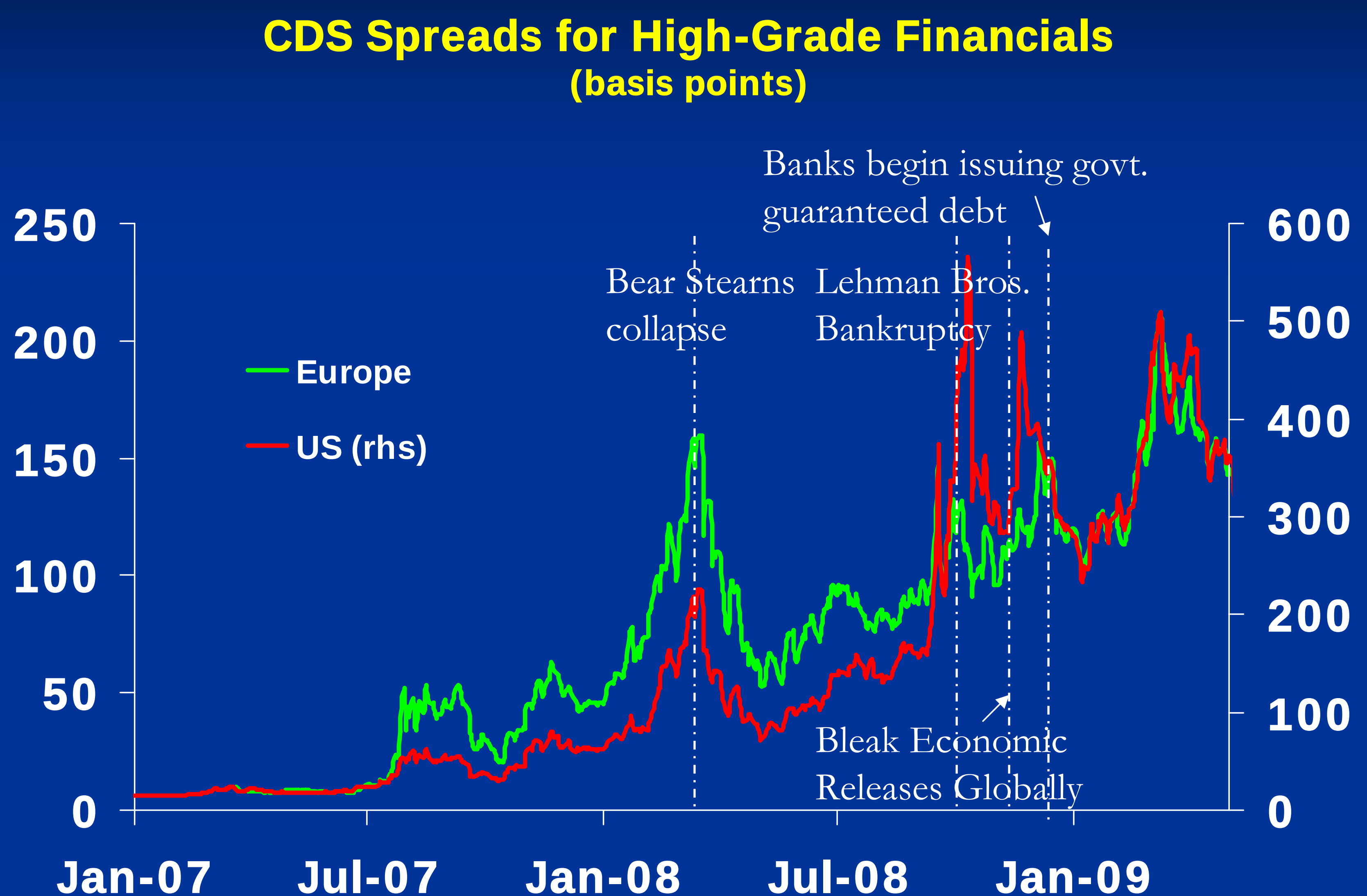
- Real and financial feedback loop
- Deflation risks
- Fiscal concerns/debt dynamics
- Negative feedback from emerging economies

U.S. housing – Signs of stabilization



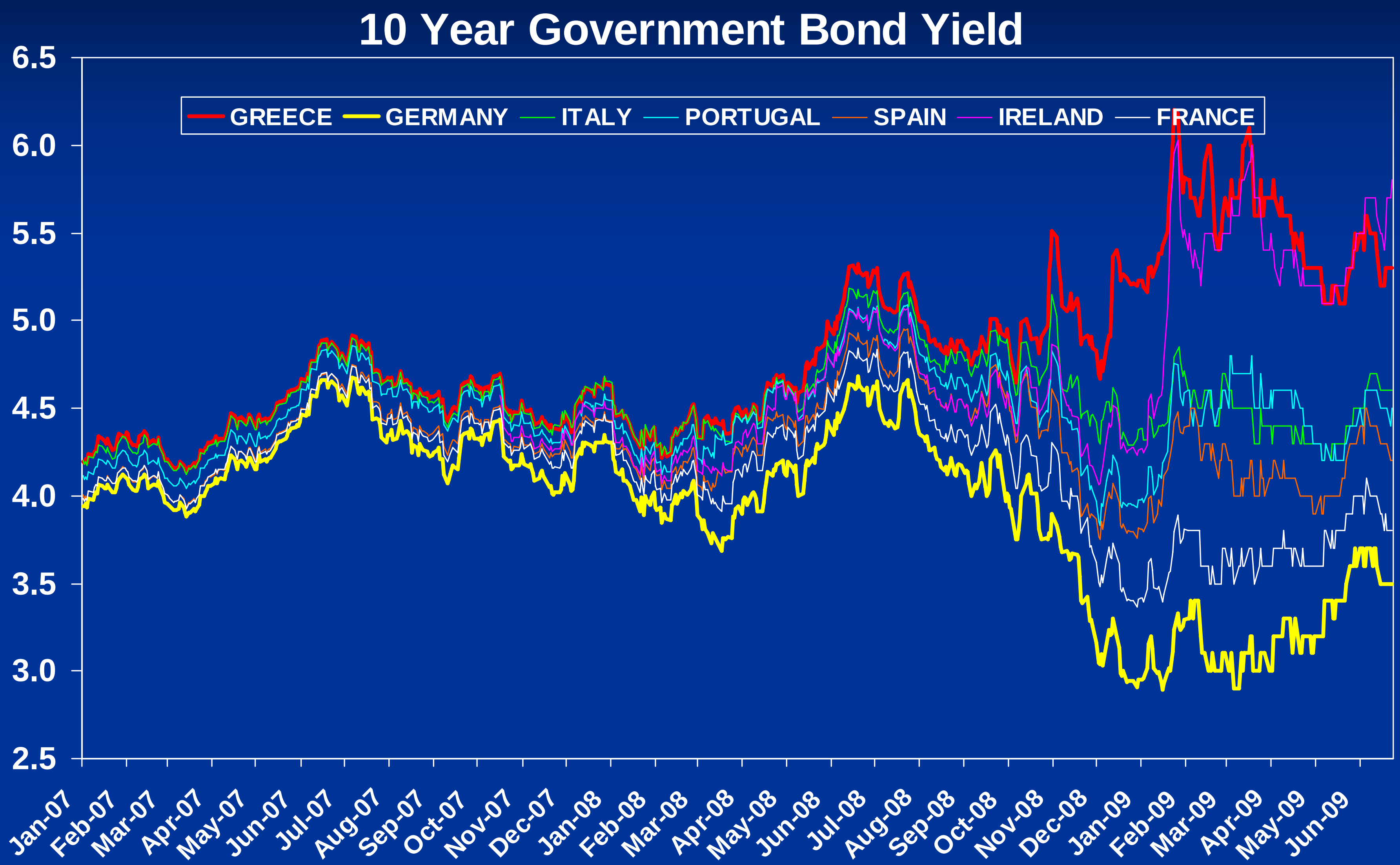


Systemic risks remain elevated despite government interventions



Source: Bloomberg

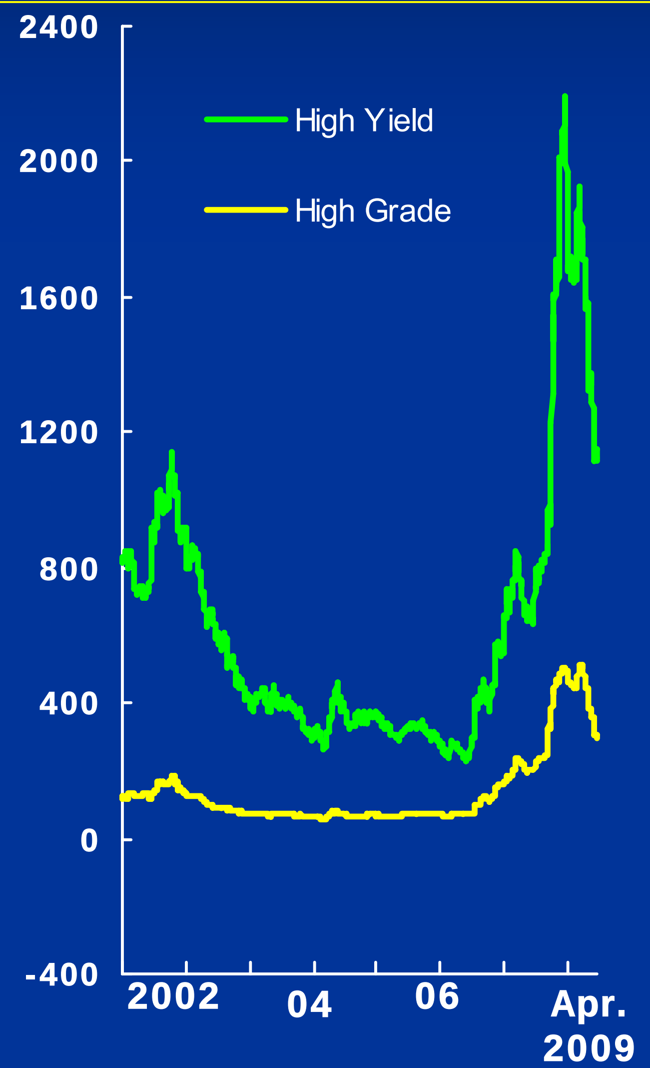
Rising concerns over fiscal sustainability…



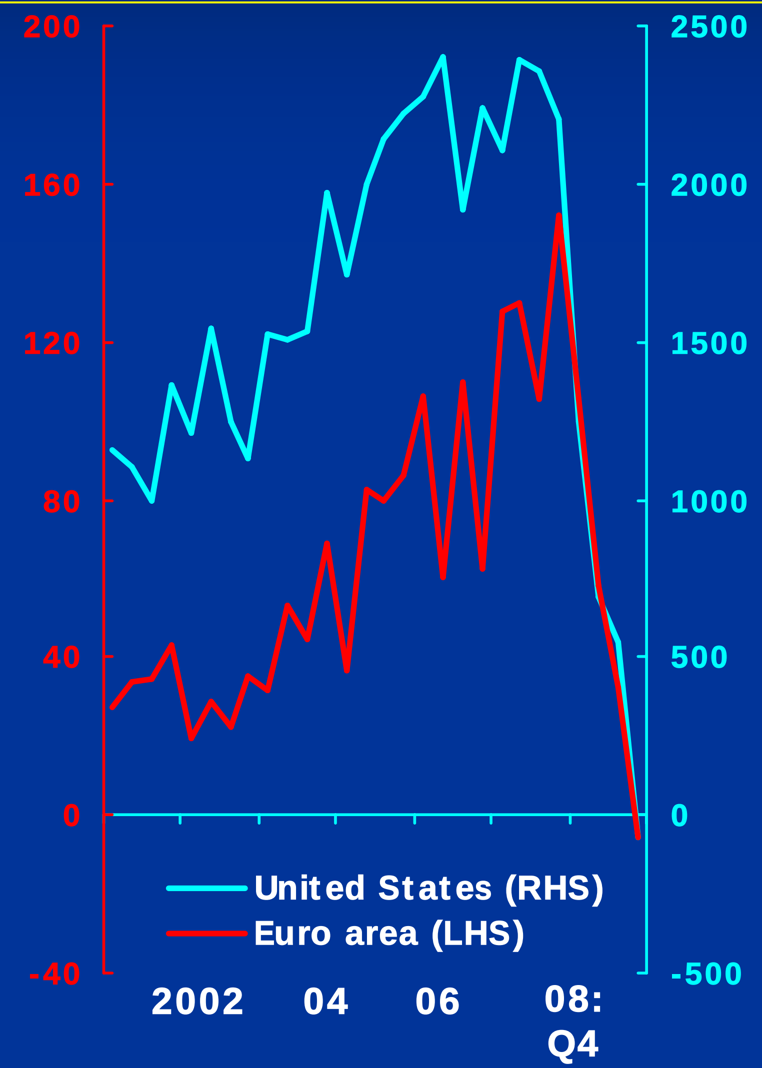
...are reflected in wider spreads over Bunds

Corporate bond spreads also remain wide; Credit is sharply curtailed as banks delever

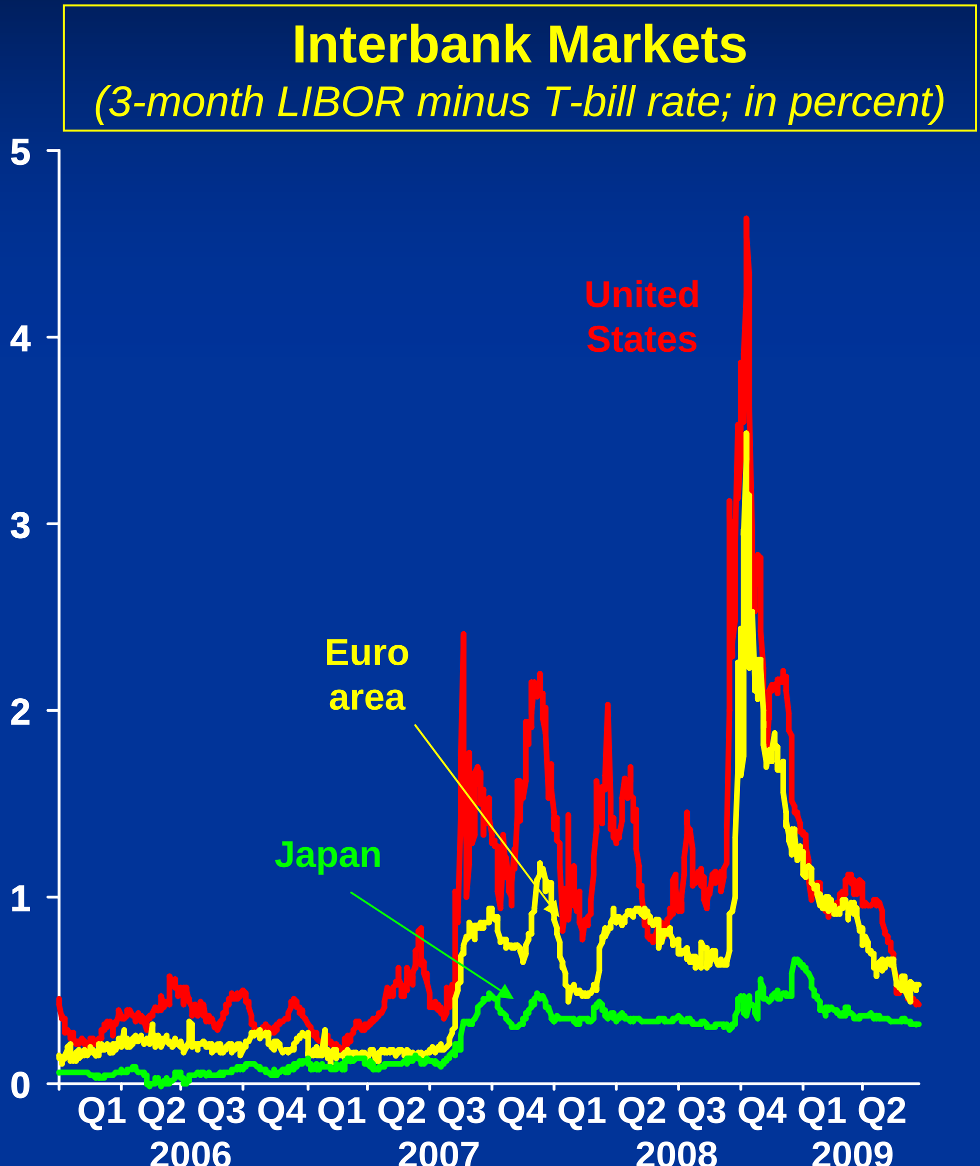
Advanced Economies:
Corporate Bond Spreads
(basis points)

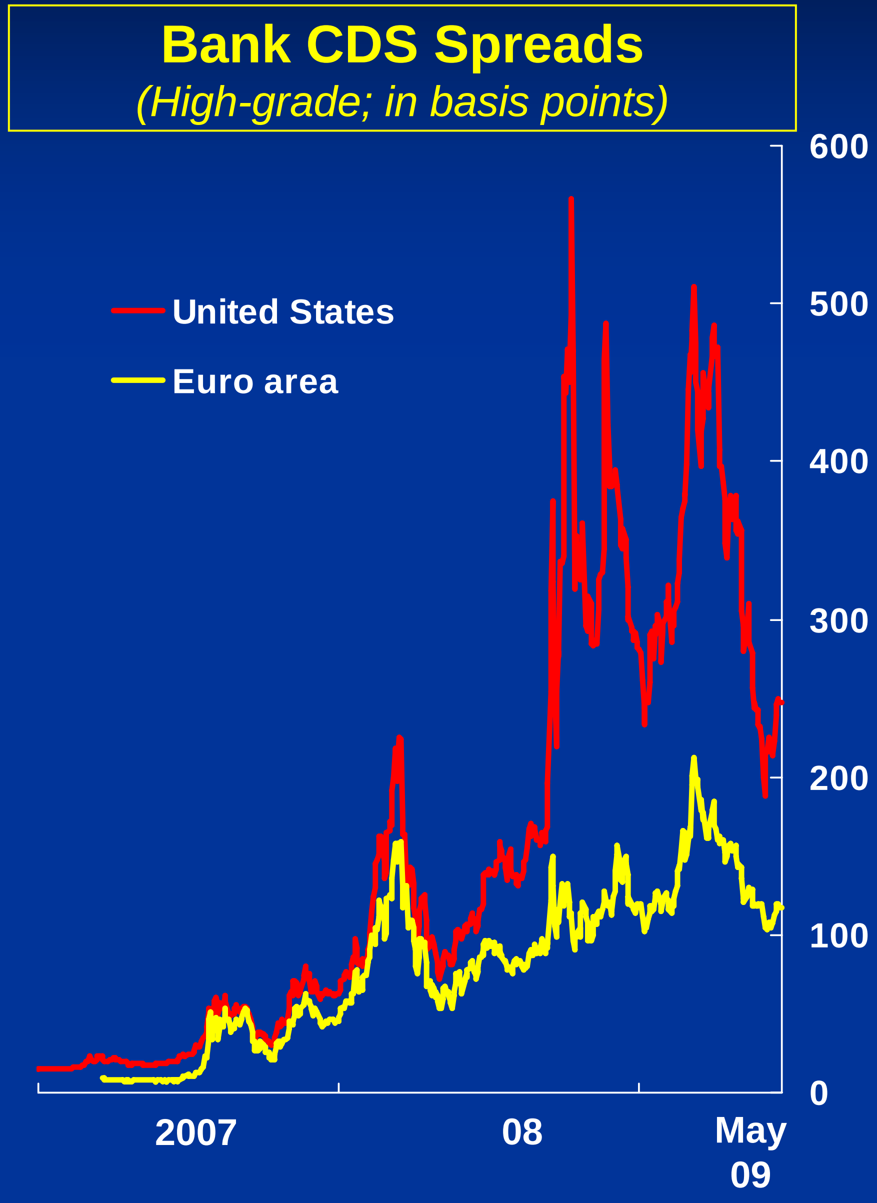


US and EU:
Credit Growth in Private Sectors
(q/q changes; in billions of local currency)

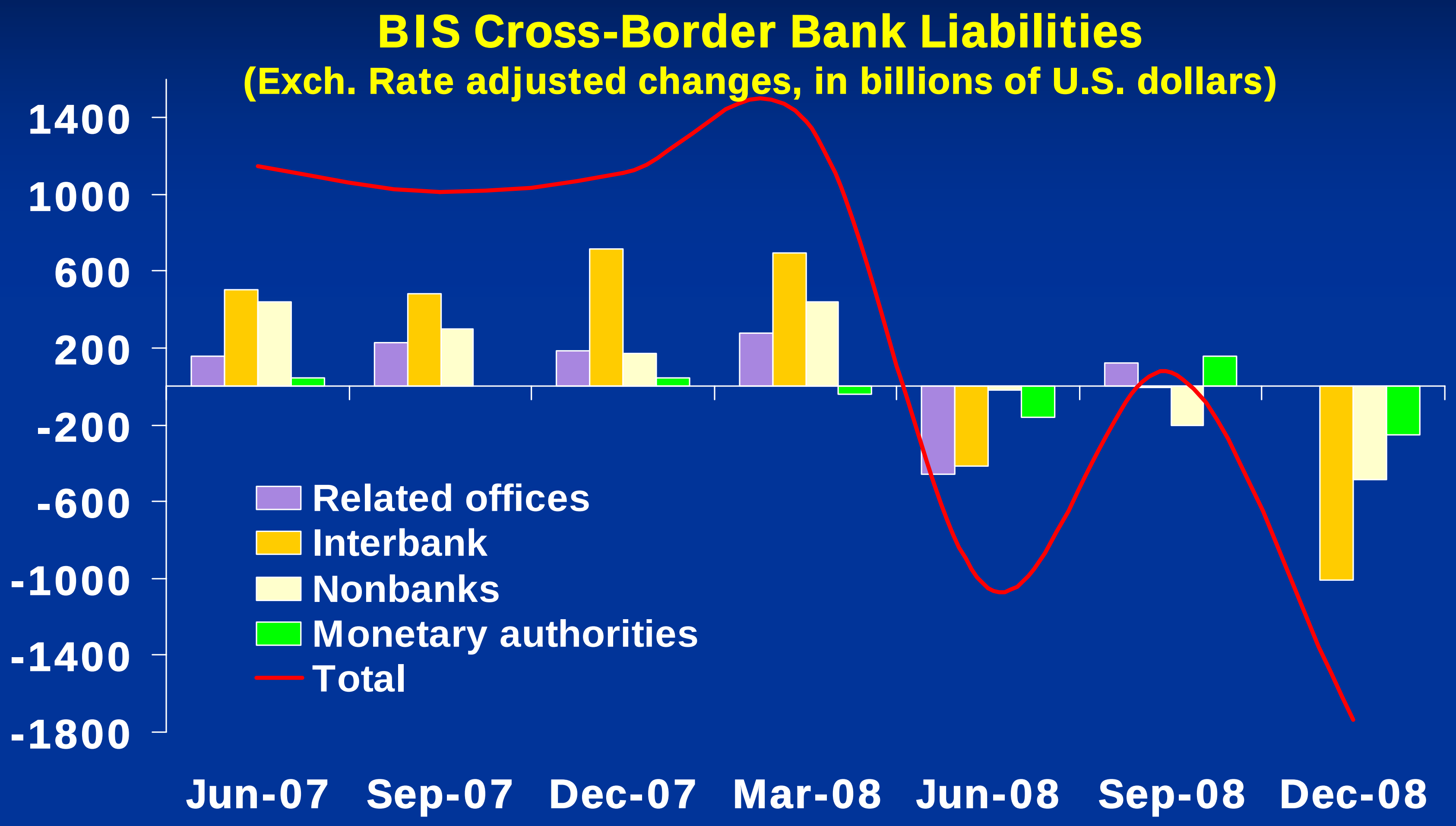


The global banking system remains under stress





Cross-border bank flows have dropped sharply

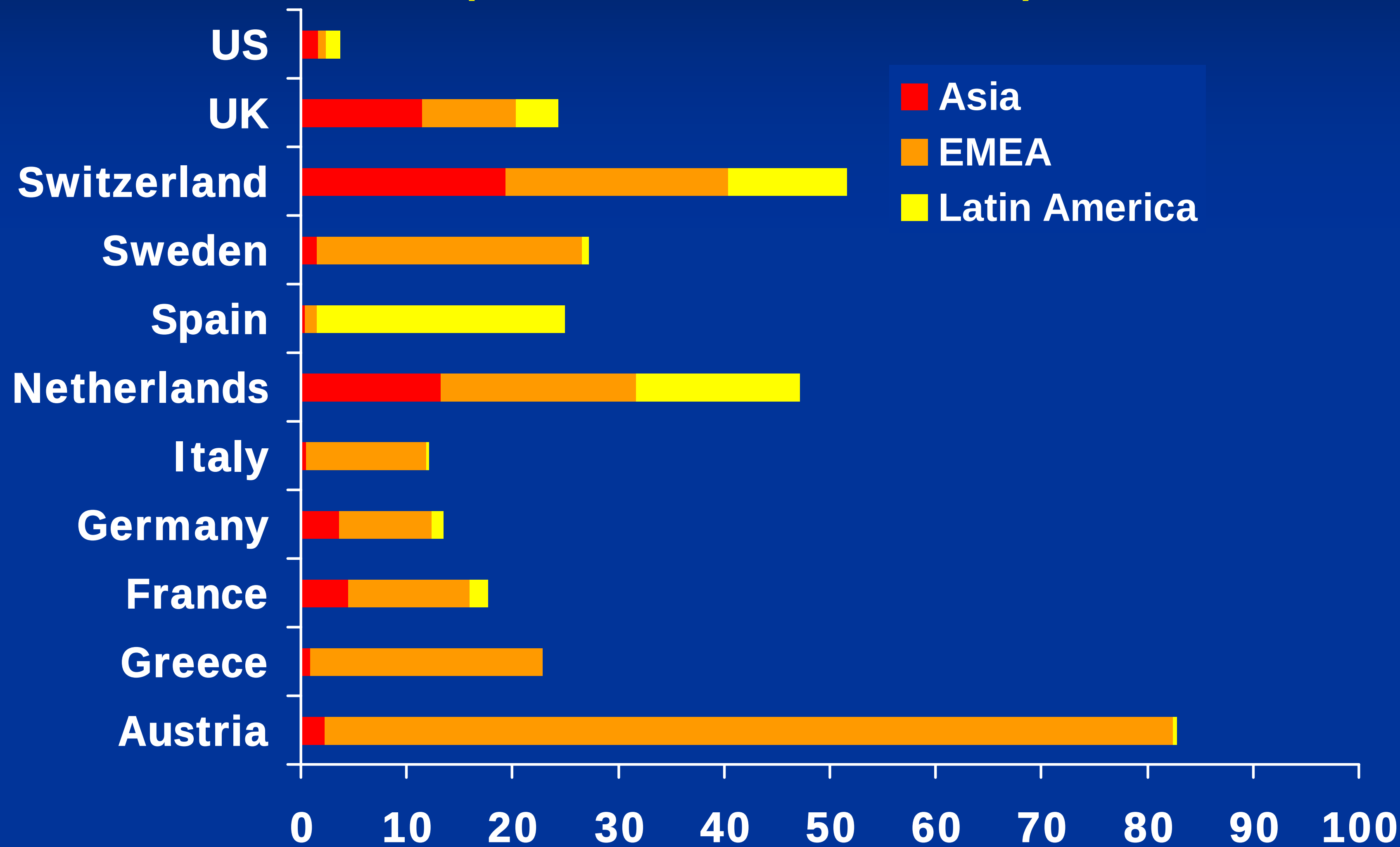


Source: BIS

Deterioration in emerging markets may, in turn, be transmitted back to mature markets' banks

Banking Systems Exposures to Emerging Markets

(as % of Mature Market's GDP)



Source: BIS

II. Policy Initiatives

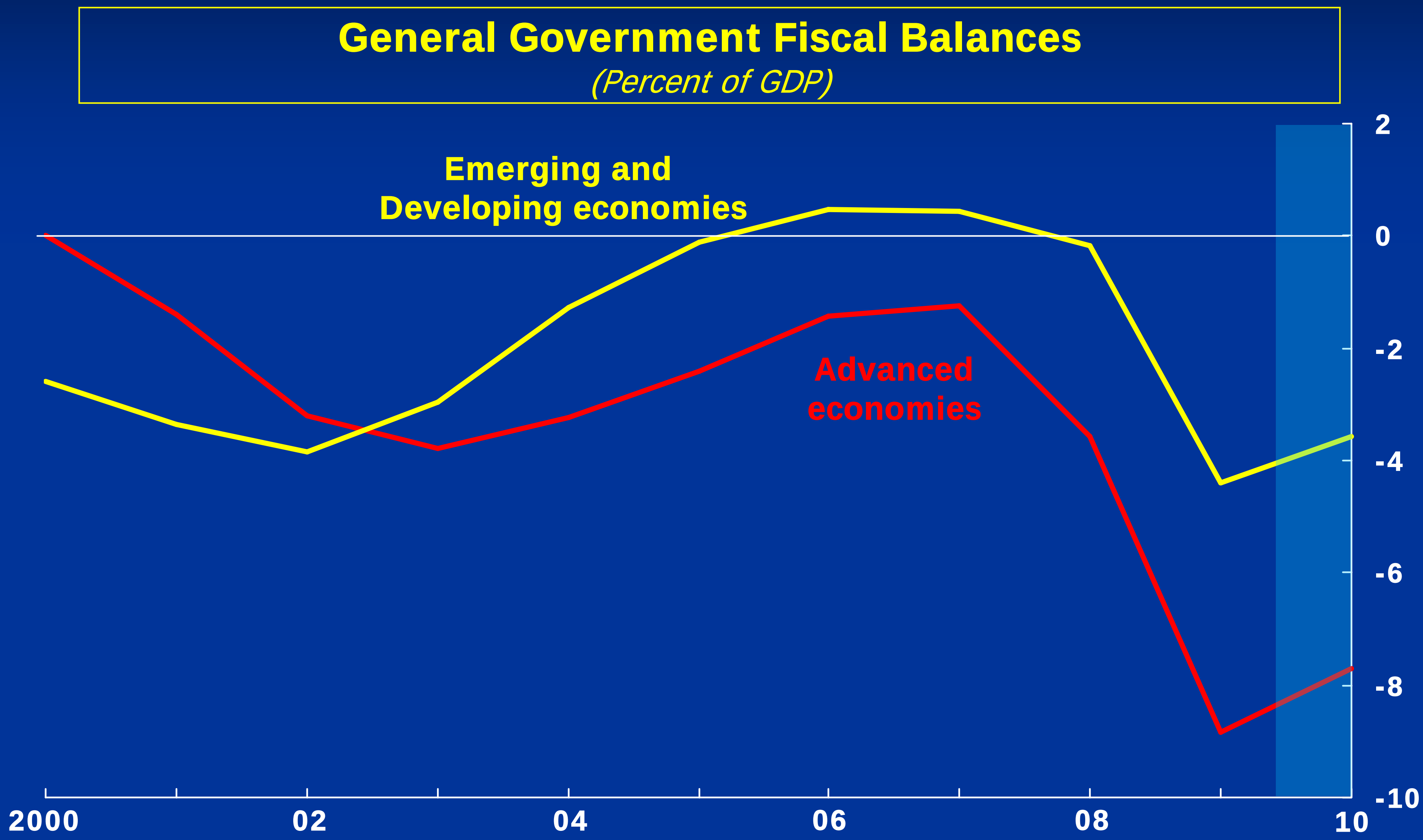
Policy Implications – Macro Policies

- Get consumers to spend more; target credit constrained consumers and firms
- Government-financed infrastructure spending
- Easy monetary policy to reduce interest rates;

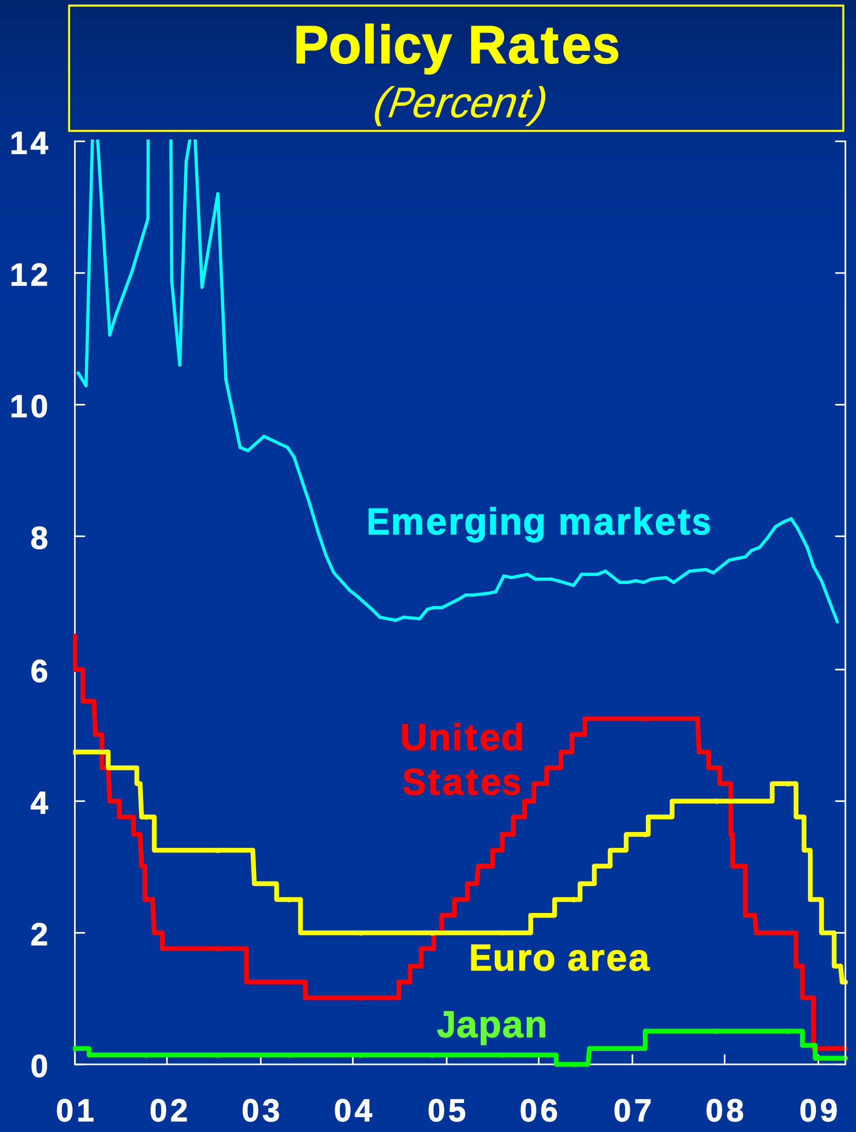
BUT:

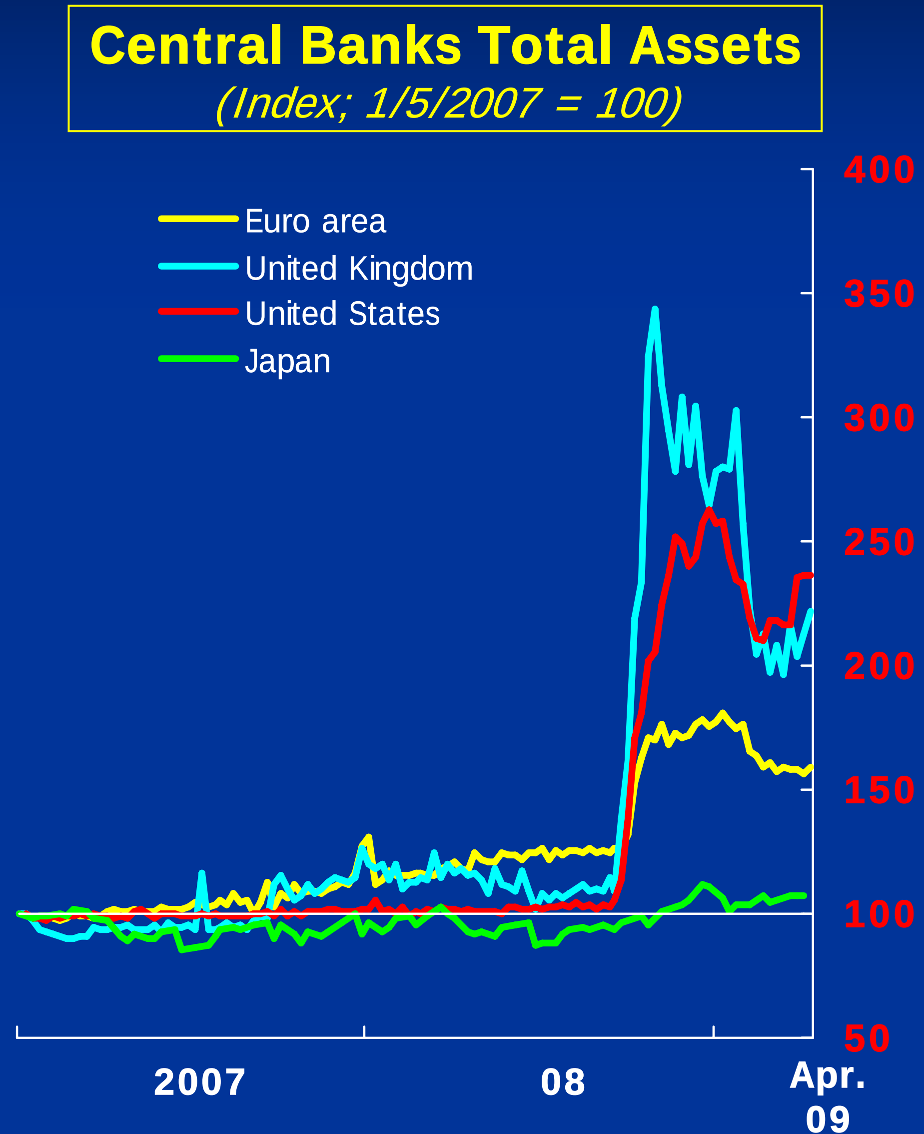
- Essential need for credible medium-term fiscal programs to ensure debt sustainability
- Many countries starting from an already dangerous position (aging, health care)

Fiscal stimulus and automatic stabilizers are expected to boost activity



Monetary and credit policies have been eased massively





Policy Implications –Financial Sector

- Restoring the financial system has three elements:
  - Liquidity provision and measures to preserve functioning financial markets (Central banks)
  - Bank recapitalization (Fiscal authority)
  - Taking bad assets off the books; sell T-bills and use the funds to buy risky assets; “bad bank” (Fiscal authority)
- To be effective, financial policies need to be comprehensive and internationally coordinated

Credit deterioration is feeding back to higher expected writedowns across all sectors

Estimates of Potential Writedowns, 2007-2010
(billions of US dollars)

Origin of Debt	Outstanding	Estimated Writedowns: October 2008 GFSR	Estimated Writedowns: April 2009 GFSR	Estimated Writedowns: Banks
United States				
Loans	13,507	425	1,068	601
Securities	13,047	980	1,644	1,002
Loans and Securities	26,554	1,405	2,712	1,604
Europe				
Loans	20,759	...	888	551
Securities	3,048	...	305	186
Loans and Securities	23,807	...	1,193	737
Japan	7,358	...	149	129
Emerging markets	...	...	...	340
Total all Loans and Securities	57,719	...	4,054	2,810

Global Policy Initiatives

- G-20 Leaders' Summit in Washington on Nov 15, 2008 agreed on 5 objectives:
  - Common understanding of the root causes of the global crisis
  - Review of countries' actions addressing the crisis
  - Agreement on common principles for reforming financial markets
  - Action plan to implement those principles and to develop further recommendations for later review
  - Reaffirmation of commitment to free market principles
- Working groups set up to make specific proposals at next G-20 Leaders' Summit in London on April 2, 2009

Global Policy initiatives

- G-20 Leaders' Summit in London on April 2 agreed to:
  - Restore confidence, growth and jobs
  - Repair the financial system to restore lending
  - Strengthen financial regulation to rebuild trust
  - Fund and reform IFIs to overcome this crisis and prevent future ones
  - Promote global trade and investment, reject protectionism
  - Build an inclusive, green, and sustainable recovery

G-20: Restoring growth and jobs

- Unprecedented fiscal expansion of $5 trillion by end-2010
- Comprehensive support to banking systems through liquidity, capital, dealing with impaired assets to restore normal flow of credit
- IMF to “assess regularly the actions taken and the global action required”

G-20: Strengthening financial supervision and regulation

- Recognition that major failures in financial regulation and supervision were key causes of crisis; implement Action Plan to address shortcomings
- Establish new Financial Stability Board (FSB); FSB to collaborate with IMF to provide “early warning system” of macro-financial risks
- Extend perimeter of regulation to all systemically important financial institutions
- Prevent excessive leverage; improve valuation standards; end bank secrecy
- IMF, FSB to monitor progress, report to G-20 Ministers in November

G-20: Strengthening IFIs

- Significantly increase IMF resources to $750 bl
- Support a $250 bl SDR allocation to increase global liquidity
- Support $100 bl of new lending by MDBs
- Welcome IMF's new Flexible Credit Line (FCL) which provides large, upfront access to financing without conditionality to countries with solid policy frameworks; Mexico was "first mover" in requesting an FCL
- Commit to complete IMF quota and voice reform by January 2011

Why expand IMF Resources?

- Without adequate IMF support, countries may be forced to contract or let their currencies weaken sharply, triggering corporate and financial insolvencies.
- The NAB enhances international stability by providing an insurance policy for the global economy. The NAB is a set of credit arrangements that the IMF maintains with 26 countries to obtain supplemental resources temporarily when the IMF's existing resources are substantially drawn down in circumstances that threaten the stability of the international monetary system.
- Ensuring adequate IMF resources through an expanded NAB provides immediate benefits in terms of confidence to markets, reducing the need for more costly rescues of crisis countries. An adequately funded IMF promotes market confidence that emerging market and developing countries have the financing they need to address the effects of the current crisis.

Large IMF financial packages since September 2008

Country	IMF ($ bl)	Total ($ bl.)	% of GDP
Belarus	2.5	7.4	13
Hungary	15.7	25.4	16
Iceland	2.1	10.9	65
Latvia	2.4	10.5	33
Pakistan	7.6	12.4	7
Ukraine	16.4	18.0	10

…and Precautionary Flexible Credit Lines

Country	IMF ($ bl)	Total ($ bl.)	% of GDP
Mexico	47	47	6
Poland	20	20	5
Colombia	10	10	5

III. Five priorities for regulatory reform

1. Extending perimeter of regulation

- "Shadow" banking system was key regulatory failure
- Perimeter of regulation must include all systemically important institutions & markets to capture & mitigate systemic risk
- At same time, need to avoid "rush to regulate" that could stifle innovation & impose unnecessary administrative burdens.
- IMF has made significant analytical contribution to the measurement of systemic risk that can help define perimeter of regulation (GFSR, April 2009)

2. Reducing excessive leverage and procyclicality

- Safeguards against systemic risk:
  - Tighter capital & liquidity rules would contribute to crisis prevention by discouraging accumulation of risks & leverage in good times
  - Measures to reduce procyclicality would create a cushion that could be drawn upon in a downturn

Originate-and-Distribute Model (O&D)

- Although somewhat tainted now, O&D is conducive to financial stability by reducing leverage without hindering credit supply.
- Leveraged institutions (e.g. banks) should keep liquid assets with rel. short maturities, and securitize longer-term, less liquid assets; these should be held by unleveraged, real-money investors.
- Regulators should encourage revival of O&D model with appropriate safeguards, incl. monitoring of off-balance sheet exposures to ensure risks are widely spread.

3. Addressing market discipline

- Disclosure practices must be strengthened for systemically-important institutions, incl. both banks and non-banks.

- Revamped set of financial indicators is needed, including off-balance sheet derivatives that turned out to be so important in this crisis.

4. Cross-border regulation

- Rules must be strengthened before problems actually occur
- Need to define rules for burden-sharing across jurisdictions
- IFI Joint Action Plan, announced in Feb 09, to provide funding to EU banks with subsidiaries in CEE countries.
- Supervisory colleges for all large cross-border financial institutions is a major step.

5. Strengthening systemic liquidity management

- Establishing a clearing facility for the CDS market would help reduce counterparty risk (now: OTC market).
- Improved mechanisms for cross-border liquidity provision are vital (ECB repos vs. swaps).
- Nevertheless: regulation, not monetary policy, is the right tool to deal with asset bubbles.

Thank you!