



International Monetary and Financial Committee

Fifteenth Meeting
April 14, 2007

Statement by Nout Wellink, President of the Nederlandsche Bank

On behalf of Armenia, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus,
Georgia, Israel, Republic of Macedonia, Moldova, Republic of Montenegro, The Netherlands,
Romania, and Ukraine

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Representing the constituency consisting of Armenia, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Republic of Macedonia, Moldova, Republic of Montenegro, the Netherlands, Romania, and Ukraine

This statement presents the view of my constituency on the topics to be addressed at the IMFC meeting: the global economy, adaptation of the IMF Surveillance Framework and other elements of the IMF's Medium-Term Strategy.

World Economic Outlook

1. The world economy expanded rapidly in recent years. In 2006, global GDP growth was above 5 percent for the third year in a row. This is the strongest performance since the early 1970s. In line with the IMF's baseline, my constituency expects another good year in 2007, though GDP growth is expected to slow somewhat. The favourable **outlook** reflects a further rebalancing of economic growth between the large economic areas. While US growth is expected to return gradually to potential in the course of 2007, Japan and the euro area are likely to grow slightly above potential. At the same time, the integration of emerging economies into the world economy, in particular China and India, remains an important driver for global economic growth.

2. While the global outlook is favourable, it is not without risks. **Inflationary pressures have generally eased somewhat, but remain a concern** as global capacity utilization has increased beyond the level of the previous cyclical boom in 2000 and labour conditions in the US and the EU might lead to pressure on wages. Another upside risk to inflation is related to oil prices. Though oil prices have levelled off since last summer, the **oil market remains a source of volatility**. On the supply side, spare capacity continues to be tight and the political situation in the Middle-East keeps posing risks. Given the rosy economic outlook, demand for oil will continue to be robust. Against this background, my constituency foresees higher oil prices than the IMF in its baseline scenario for 2007.

3. Funding conditions have been very supportive to global economic growth over the past few years. Real long-term interest rates remain at historically low levels in major economies, despite that central banks in these regions having tightened their policy stance. Buoyant credit growth has manifested itself in elevated prices across a wide range of assets. In the respect, the recent developments in the US housing and relevant credit markets stand out. While the IMF suggests that the housing correction may be approaching its bottom, **a more protracted slowdown in housing prices** should not be ruled out in the event of larger than expected defaults and foreclosures in the sub-prime mortgage market and contagion effects to other segments of the mortgage and related secondary credit markets. **A sudden change in investors' risk-appetite**, for example due to stronger than expected interest rate increases, could lead to a severe price correction in more risky asset classes, such as certain sub-prime mortgages, junk corporate and emerging market bonds.

4. Global imbalances persist, although the US budgetary deficit recently declined, US export growth was strong and output performances were better outside the US. That said, adjusting global imbalances requires more, including increasing US household savings. Other countries also have a role to play. Asian countries could allow for more flexible exchange rates, whereas countries in the Middle-East could improve their investment climate. Although the direct role of the euro area in (reducing) global imbalances is limited, implementation of ambitious structural reforms, would better protect the euro area against a disorderly unwinding of these imbalances.

Surveillance and crisis prevention

5. My constituency **welcomes efforts to further strengthen surveillance**, in which the proposed revision of the 1977 decision on exchange rate surveillance plays an important role. The goal of this revision should be to reconfirm the role of the Fund: to promote a stable system of exchange rates against the background of increased capital mobility and of the changed role of exchange rate policies in general. My constituency supports the proposals by the IMF to underline the importance of external stability and to prevent negative spill-over effects, conditioned by a sustainable balance of payment position. This will firmly anchor current best practices in the field of surveillance within the guidelines of the IMF. My constituency emphasizes that the revision needs to contribute to greater effectiveness and efficiency of IMF surveillance, especially by introducing more focus. Surveillance should,

therefore, pay attention to monetary policy, fiscal policy and financial sector policy, and only insofar as they are relevant for external stability to other domestic policies.

6. The emphasis on external stability also implies that members should avoid exchange rate policies potentially leading to fundamental misalignments of the exchange rate. Internal analyses by the Fund are necessary in order to give a sound judgement on whether the exchange rate regime or level is favourable to external stability and the country's economy.

The IMF should be reticent about the communication of exchange rate equilibrium assessments, given the market sensitivity of that information as well as the degree of uncertainty in the determination.

7. With respect to **a possible surveillance remit, my constituency thinks that there is value in clearly stating the Fund's priorities**. We want to emphasize that this exercise should not lead to an unnecessary bureaucratic process. We think that the current proposals should further await the outcome of the revision of the 1977 Decision, which should provide the overarching framework of surveillance.

Other Elements of the IMF's Medium-Term Strategy

8. My constituency feels all issues mentioned under "Other Elements of the IMF's Medium-Term Strategy" are of great importance to the Fund and would like to comment on the following elements: The Fund's income position, governance and quota, the role of the Fund in emerging market economies, and the collaboration with the World Bank and the role of the Fund in low-income countries.

The Fund's Income Position

9. My constituency welcomes the Report to the Managing Director by the Committee of Eminent Persons on the Sustainable Financing of the Fund. The report presents a balanced package of income generating measures. **In the view of my constituency, it is a sensible choice to make a distinction between the three activities of the Fund: credit intermediation, the provision of public goods and the provision of bilateral services.** Decisions on income generating measures, however, should always be taken in an integrated budget framework that includes both the revenue and the expenditure side.

10. **My constituency supports new sources of income which generate a more stable income stream.** The sale of a ring-fenced amount of gold and broadening the investment mandate of the Fund should be part of a package of measures. The latter can be done at the cost of a limited risk increase. My constituency also supports the principle of investing quota, but would like to stress that depositing quota, for investment by the Fund, imposes opportunity costs to members. The SDR interest rate that members receive on deposited quota is lower than the return on investment generated by central banks. We therefore invite staff to study the possibility of raising the unremunerated part of reserve tranche positions, at least for countries which currently have a low unremunerated part as well as for members that have already drawn their reserve tranche position. This would reduce the Fund's expenditure on remuneration and would therefore limit the quota that countries would be required to deposit.

11. **My constituency supports the report's idea of charging for bilateral services to the extent that countries can afford this, as countries should remain able to benefit from the bilateral services of the Fund.** Charging for services could ensure commitment of the receiving authorities and it could lead to a better allocation of bilateral services.

IMF Governance and Quota

12. My constituency welcomes the ongoing discussions on IMF quota and voice. We hope that the IMF member states together can reach agreement on a substantial and credible package of reforms, as initiated at the Annual Meeting in Singapore, within the timeframe set in the resolution.

13. A new quota formula should be based on the principles of sound economic policies. It should reflect integration in the world economy and it should not create perverse incentives. Any new formula should therefore adequately capture the **size, as well as the role** of countries in the world economy, expressed in both GDP and openness. Given the growing influence of international capital flows on global financial stability, openness should be **included in a new quota formula both in trade and financial terms.** From an economic perspective, the calculation of GDP using market exchange rates is appropriate.

14. A new formula should also be transparent and should be the only reference point for changes in the quotas of member states. If the formula would need to be supplemented by ad hoc adjustments, the revision of the quota formula would miss its goal of creating a fair and

transparent mechanism for allocating quota. As such, a formula should be designed by applying a compression factor.

15. My constituency views a **substantial increase of basic votes** and subsequently safeguarding their relative size as an essential part of the package, to be implemented at the latest concurrently with the second-round of ad hoc quota increases. In order to further improve the voice of low income and transition countries, my constituency is in favour of **allocating more resources to chairs representing a large number of countries.**

16. My constituency **supports a second round of ad hoc quota increases** that is applied evenhandedly once a new quota formula is agreed upon, the possible size of which cannot be prejudged. If at a future point in time a general quota increase is deemed necessary in view of Fund liquidity, my constituency is open to consider achieving further quota rebalancing.

The Role of the IMF in Emerging Markets

17. My constituency **has a positive stance towards the possible introduction of a new liquidity instrument.** Such an instrument should minimize challenging issues such as stigmatization, the exit problem, moral hazard and compromising the level of conditionality. This new instrument, conceptually in the form of a Reserve Augmentation Line should not crowd-out existing instruments in circumstances where the latter are better suited, i.e. Precautionary Arrangements for fostering macro-stability and underlying structural improvements. In our view, automatic access should be limited to three hundred percent of quota. Additional access could be facilitated under a regular fund arrangement.

IMF-World Bank Collaboration and the role of the Fund in Low-Income Countries

18. **On the Report to the Managing Director and World Bank President by the External Review Committee on IMF-World Bank Collaboration,** we support the report's main thrust of creating a spirit of collaboration. In our view, a clear demarcation of responsibilities is a crucial condition for effective cooperation. We therefore invite both the Bank and the Fund to draw up more specific proposals for a clear division of labour and responsibilities between the two institutions.

19. **My constituency does not support the proposal to merge the IBRD Board and IMF Board.** We feel that this would constrain the knowledge and involvement of Executive

Directors vis-à-vis their respective institutions and would therefore limit the effectiveness and opinion of the guidance they provide. It would ignore the specific tasks and responsibilities that Executive Directors have in both institutions.

21. **The IMF should clarify its role in low-income countries.** The Fund should focus on macroeconomic and external stability, whereas the Bank should focus on poverty alleviation and long-term economic growth. Meanwhile, the Fund should gradually withdraw from baseline financing such as provided under PGRF, since this is not a core competency of the Fund. Other instruments, such as the PSI, should allow the Fund to continue to play its useful role in low income countries. Moreover, the Fund should keep providing short-term balance of payments support to low-income countries in line with its mandate. In the light of IEO's report on the Fund's aid to sub-Saharan Africa, we believe that both institutions should make sure that the conditionalities they attach to their financing not only promotes macro-economic stability but also contributes to creating the right conditions for balanced growth and effective poverty reduction.