International Monetary and Financial Committee

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**Statement by the H.E. Sultan N. Al-Suwaidi,
Governor of the Central Bank, United Arab Emirates**

On behalf of Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libyan Arab Jamahiriya, Maldives, Oman, Qatar, Syrian Arab Republic, United Arab Emirates, Republic of Yemen

Statement by His Excellency
Sultan N. Al-Suwaidi
Governor of the Central Bank
of the United Arab Emirates

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I. The Global Economy and Financial Markets—Outlook, Risks, and Policy Responses

1. Despite significant policy efforts, the dramatic intensification of the financial crisis has continued to provoke an unprecedented contraction in economic activity and trade, particularly in the industrialized countries, and induced a globally synchronized downturn. The speed of the recovery will obviously depend on the measures that policymakers take and their ability to restore confidence and stability of financial systems. There is limited evidence, however, that these efforts have firmly arrested the downturn, and restoration of confidence has proved elusive. Against this background, the **global economy** is expected to contract sharply in 2009, by about 1½ percent of GDP, and experience a sluggish recovery through 2010. With major advanced economies facing recessions, the near-term outlook for emerging market and developing countries (EMDC) will be particularly challenging, as the adverse impact of intensifying trade and financial spillovers fully unfolds.

2. **Risks to the economic outlook are predominantly on the downside**. With the current downturn combining a financial crisis and a synchronized recession across several major countries, a recovery may well be delayed, for several reasons. First, with the next wave of defaults likely to come from the corporate and household sectors, especially in the U.S., financial market stabilization could take longer than previously envisaged, undermining prospects of a recovery. Second, unless bank balance sheets are restored and financial conditions normalized, ongoing and prospective monetary and fiscal policies in support of demand may fail to gain traction. Third, rising concerns about longer term fiscal sustainability in many countries might further reduce the scope for sustaining countercylical policies beyond 2009. Finally, for many EMDC suffering from the sharp decline in external demand and financing flows, unless their near-term financing needs are appropriately met, the offset to the weakening outlook in advanced economies would fail to materialize. Determined actions are thus needed to arrest the negative feedback loop between financial sector stress and weakening economic activity, restore confidence in the financial system, and contain the spillovers to EMDC.

3. **Considerable uncertainty surrounds the medium-term outlook on inflation**. For many advanced economies, the concern in the near-term has shifted toward countering deflation risks, especially in the U.S. and Japan, and to a lesser extent in Europe. Substantial monetary easing and fiscal stimulus measures have been deployed to support domestic demand and economic activity, and may need to be sustained until a recovery firmly takes hold. However, the post-crisis outlook for inflation could potentially be complicated by a variety of factors, including the pace at which the fiscal stimulus measures are withdrawn as output levels recover and how these would be sequenced with monetary policies. A

premature policy tightening could undermine the recovery; however, averting inflationary pressures requires timely exit strategies.

4. In the **United States**, despite massive countercyclical policies to support credit demand and restore confidence in financial markets, conditions remain difficult and the economy is expected to contract by about 3 percent in 2009. Policy responses so far have been sizable. Monetary policy has been eased significantly and the Fed has started to deploy the size and composition of its balance sheet to support credit markets. A large fiscal stimulus package is also being phased in, and importantly, additional public resources have been allocated to the dual objective of cleansing distressed assets from bank balance sheets and supporting bank recapitalization. Going forward, the prospects for a durable recovery hinge critically on the effectiveness of measures to restore financial sector confidence and stability. The scope for further expansionary measures should carefully consider the effectiveness and implications of fiscal and monetary policies already undertaken—which admittedly may be somewhat premature at the current juncture.

5. The outlook for **Europe** is even more challenging, reflecting the damage by trade spillovers and financial stress from exposure to U.S. securities markets, housing corrections in some markets, and the additional exposure in some countries to emerging European countries. A particularly sharp contraction is projected for 2009 and possibly for 2010, despite implementation of expansionary demand management policies. Going forward, the scope remains for further easing of policy interest rates to counter weakening activity. However, the space for additional fiscal support is likely to be limited, and policy-makers will need to balance the need and scope for providing further support to the financial sector and to aggregate demand against the potential deterioration of confidence in government solvency that may arise from mounting debt stocks and their attendant impact on interest rates and spreads. The latter consideration is also relevant for the **Japanese economy**, where the scope for further fiscal easing to counter a strong contraction and deflation risks could be constrained by the high debt levels.

6. An overarching policy challenge for **EMDC** is to engineer a relatively smooth adjustment to the sharp drop in external demand and capital inflows arising from the economic downturn and financial sector stress in advanced economies. Revenues from exports, especially from commodities, tourism, and remittances will be depressed, at a time when deleveraging is raising borrowing costs. Emerging market sovereigns and corporates with financing needs further run the risk of being ‘crowded out’ as mature economies issue and guarantee substantial amounts of net debt in response to the crisis. Significant reserve buffers and improved macroeconomic frameworks are providing the room to cushion the effect of the crisis, including in China, India, and Middle Eastern economies. While recognizing that the policy space differs across countries, the scope for countercyclical measures may generally be more constrained for EMDC compared to advanced economies. The scope for monetary easing to support domestic activity against a weakening external environment may be constrained by possible pressures on the balance of payments, reserves and exchange rate levels. Even for countries with relatively comfortable reserve buffers, the pace of the drawdown of reserves would have to be calibrated against a potentially prolonged downturn, and possibly supported by policy adjustment.

7. Like many EMDCs, countries in the **Middle East region** have not been spared the impact of the crisis. In addition to large declines in oil prices, deterioration in external financing conditions and reversal of capital flows are dampening growth prospects. Growth in the region is projected to slow sharply to 2.5 percent before picking up in 2010, although growth outcomes will be different across countries. For oil exporting GCC countries, the decline in oil GDP resulting from OPEC cuts is likely to be offset by robust growth in non-oil GDP. Financial buffers accumulated during the boom years as well as much strengthened policy and macroeconomic frameworks in many Arab countries allow the scope for supportive policies to cushion the impact of the crisis.

8. In several countries, high government spending is deployed to support domestic demand and mitigate the impact of retrenchment in private sector activity. Where liquidity pressures emerged, central banks across the region have acted swiftly by providing liquidity and lowering reserve requirements. Countries with pegged exchange rates have additionally benefited from the continued monetary easing in the U.S., further reinforcing the stabilizing role of the exchange rate peg in oil producing economies. Policy responses in the financial sector have also been swift with measures aimed to shore up confidence and prevent systemic banking crises. Looking ahead, governments stand ready to provide additional support as needed to shield the financial sector and domestic activity from further deterioration in global conditions.

II. IMF Crisis Response and Reform Agenda

9. The Fund has effectively stepped up to the challenges posed by the ongoing global turmoil in terms of incisive analysis, tailored policy advice, and a modernized financing framework—all within the confines of a much reduced staff workforce. The Fund's critical role in mitigating the current crisis, conferred to it by its mandate and its unique expertise in macrofinancial analysis and crisis resolution, is now widely acknowledged. Fund analysis on lessons from the crisis and policy recommendations have been called upon extensively in guiding deliberations of international fora, notably the G-20. It is incumbent that these efforts be met with credible commitments to increase the Fund's loanable resources and advance on a new income model, to instill confidence in its continued ability to assist the membership in coping with the ongoing crisis.

Advancing the IMF Surveillance Agenda

10. The Fund's analysis distilling the main lessons from the crisis provide an important building block in guiding future efforts to strengthen Fund surveillance and its traction and reinforce its oversight role of global financial stability. It is generally agreed that our **surveillance** did not sufficiently identify or warn of the build-up of systemic risks that emerged as a result of lax regulation toward higher leverage, lower lending standards, and greater risk-taking. Going forward, more attention should be accorded to the analysis of systemic risks, including through focus on asset price booms, leverage, risk concentration in large banks, and hidden or off-balance sheet risks. *For surveillance to have traction, our messages should be sharper and more convincing and not muted or obscurely embedded in lengthy discussions. Equally important, however, is for members to be appropriately receptive to the candor of these messages.*

11. Analysis of **macro-financial linkages** and cross-border spillovers should continue to be sharpened. The joint Fund-FSB early warning exercise (EWE) is welcome, although we would note that the exercise holds the promise of potential benefits as well as risks both to the member and the Fund if not carefully implemented. The idea of identifying systemic risks and vulnerabilities, prioritizing them, providing policy makers with options to mitigate them, and influencing policy action by highlighting the potential risks of inaction, is potentially appealing. However, *it is wise to remember that crises are fundamentally unpredictable, and that sounding false alarms and repeated unspecified warnings would risk fatigue and inaction*.

12. On regulation and **reform of the global financial architecture**, the priorities identified by the Fund are appropriate, including expanding the perimeter of financial sector surveillance, discouraging regulatory arbitrage, addressing procyclicality of existing rules, and filling informational gaps. Going forward, Fund should take the lead in further refining the analytical underpinnings related to the following: *(i) redesign of central bank liquidity frameworks, (ii) distilling the lessons from the macro-financial implications of quantitative easing, (iii) the costs and related policy risks of official support to the financial sector (including temporary government ownership) and (iv) potential solutions to valuation of illiquid securitized financial assets and financial sector clean-up.*

13. On **fiscal policy**, Fund analysis has also usefully distinguished between the direct costs of the financial sector bailouts and other indirect costs of the recession, underscoring the cost of inaction or delayed action as we head toward rapidly accumulating debt stocks and contingent liabilities. The well-structured analysis of the fiscal costs, including outlays on stimulus measures, automatic stabilizers and indirect effects on fiscal revenues, provide a useful headline summary of fiscal costs by country and in aggregate, which should be regularly updated. *The Fund should continue its assessment of the costs and impact of the large fiscal stimulus measures undertaken in several countries, and of their longer-term macroeconomic implications.* Going forward, lower-than-projected growth or a more prolonged stagnation would further exacerbate deteriorating debt dynamics. Accordingly, for many advanced economies, *there is an urgent need for medium-term frameworks to anchor expectations and reassure markets of the inherent solvency of fiscal positions. The Fund should continue to press forth this message*.

14. On **medium-term policy challenges and prospects beyond the crisis**, *Fund analysis should aim at identifying policies that are conducive to a rebalancing of global sources of growth and to a reduction in saving-investments gaps*, including through orderly adjustment of exchange rates. Such analysis should take into account the post-crisis financial landscape which would feature a less leveraged financial sector and potentially structurally lower capital flows to EMDC, and a global recovery less driven by U.S. consumption.

Lending Framework

15. **GRA Reforms.** The Fund has moved expeditiously to overhaul its lending toolkit and conditionality framework to increase the effectiveness of its crisis prevention and resolution efforts. The Fund's crisis prevention role has been significantly strengthened with the adoption of the Flexible Credit Line (FCL)—a dedicated contingent financing instrument that

provides for large upfront resources to countries with strong policy track record and sound fundamentals—as well as reforms to high access precautionary arrangements (HAPA). Access limits were increased, and the surcharge framework was simplified while allowing for an appropriate pace of reserve accumulation. Importantly, the conditionality framework has been modified to allow for better tailoring to members' evolving needs and circumstances while providing adequate safeguards for Fund resources. The introduction of ex-ante conditionality would go a long way in reducing perceptions of intrusiveness on the part of the Fund in the economic decision-making process in member countries. We commend the Managing Director for his leadership role on these issues.

16. **LIC framework**. The Fund's lending toolkit for LICs needs to be more flexible in light of increasingly diverse country needs and heightened exposure to global volatility. Progress is being made on reform of the financing framework for LICs, and we welcome the recent doubling in access limits and norms under the PRGF and ESF. Discussions are ongoing to explore options to expand resources for concessional financing to LICs, consistent with principles and decisions agreed under the new income model. In this connection, we note that subsidy resources are currently adequate to support increased lending to LICs for the next two years. Resources to support LIC financing after 2011 should come primarily from the traditional channel of bilateral contributions.

Supplementing the Fund Resources

17. **The Fund must be adequately funded and strengthened** to instill confidence in its ability to assist members in dealing with the crisis. The unprecedented nature of the current crisis warrants a pragmatic and forward-looking assessment of the adequacy of Fund resources. Compared to relevant economic and financial metrics, the size of Fund resources have diminished significantly since the last general quota increase in 1998. We remain of the view that quota increases should continue to be a primary measure to increase Fund resources*, and call for a prompt initiation of discussions on the next round of quota increases*. In the meantime, however, borrowing remains the most viable option to mobilize supplementary liquidity in a timely manner, and we welcome the ongoing efforts exploring various modalities to expand Fund resources. In addition, an allocation in the amount of SDR250 billion would help provide a needed cushion by directly increasing members' international reserves.

18. Finally, for the Fund to effectively carry out the mandate entrusted to it by the ongoing crisis, a **sustainable income model** must be in place. The increased income from lending is transitory, and should not be relied upon to finance other activities of the Fund. *We call on members to move decisively on ratifying the agreements for a new income model.*